

Influence of Selected Factors on the Choice of Capital Structure of Small and Medium Enterprises (SMEs) in Kiambu County, Kenya

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Abstract

This study is on the effect of selected factors influencing the capital structure of small and medium size enterprises in Kiambu County, Kenya. SMEs play a pivotal role towards the achievement of the broad goals outlined in vision 2030 and are critical drivers towards making Kenya an industrialized country with high quality of life for its citizens. The study observes that despite their significance, past statistics indicate that 3 out of 5 SMEs fail within the first few months of operation and those that continue 80 per cent fail before the fifth year; it is therefore necessary to eliminate the many constraints facing these small businesses for Kenya to become an industrialized state by the year 2030. The objectives of the study were to determine the effect of firm size, information availability, purpose of finance, cost of finance, and collateral requirement on the capital structure of SMEs in Kiambu County. The study findings will assist Government planners in understanding how to come up with policies that will help the SMEs sector in raising affordable capital as this will have a great impact on the country's economic growth; financiers will benefit from the findings by developing a better understanding of the factors that influence the capital structure of SMEs. In addition, the findings from the study will contribute to knowledge about financing decisions of SMEs. The study was guided by pecking order theory, credit rationing theory, the agency theory, and the life cycle approach. This study utilized descriptive research design, employing survey methods. The population of interest are the 889 SMEs in Kiambu County registered in the Kiambu Business Directory. The study used proportionate sampling by utilizing a sample of 268 respondents, determined by Fisher's formula. The data were collected from interview schedules using questionnaires. Descriptive and inferential statistics (Pearson's correlation and regression). Data were presented in figures and percentages on pie charts and frequency distribution tables for easier interpretation. The study findings indicated that the size of the business influenced the capital structure of the firms to great extent (33.6%) and to greatest extent (33.6%) respectively compared with those who were not sure at 18.7%. Availability of information influenced choice of capital structure to a great extent (36.2%) and to greatest extent (45.5%) respectively. The purpose of the finance influenced choice of capital structure to a great and greatest extent according to 39.9% and 47.8% of the respondents. Personal savings were generally recommended for SMEs with 22.0%, 29.1% and 48.9% of the respondents indicating average, high and very high recommendation. Family and friends borrowing got mixed recommendation with 23.5% and 24.3% of the respondents indicating low and high recommendation respectively, compared with 45.1% who gave average recommendation. Finally, the research sought to test the hypotheses in order to fulfill the objectives of the study by using Pearson's correlation and regression model and applying t-test to test for the significance in the relationship. All of the null hypotheses were rejected on the basis that the significance of the t-statistic was 0.000 which was less than p-value 0.05 set for the study. Therefore, all the selected factors had an impact on the choice of capital structure for SMEs in Kiambu County.

Keywords: Capital Structure, Small and Medium Enterprises

Introduction

In both developing and developed countries, Small medium enterprises (SME) play important roles in the process of industrialization and economic growth (Akhabonje & Namusonge, 2016). The significance of Small and Medium-size Enterprises (SMEs) in economic development has been recognized worldwide. Abor (2008) and Floyd and McManus (2005) reinforce this recognition in the observation that most developing countries, have an absence of many large firms thus implying that the SME sector is the main engine of growth.

Majority of SMEs in developed countries have been found to be heavily dependent on bank finance (Benneworth, 2004). The differences in institutional arrangements and financial markets between developed and developing countries actually merit the need to look at the issue of SMEs financing from the perspective of developing economies, especially within the context of sub-Saharan Africa. Small and Medium Enterprises (SMEs) have an important role to play in the development of the country. A strong SME sector contributes highly to the economy, contributing to the gross domestic product, by reducing the level of unemployment, reduction in poverty levels and promotion of entrepreneurship activity.

In Kenya, Kithae, Gakure and Munyao (2012) explain that SMEs play a pivotal role towards the achievement of the broad goals outlined in vision 2030 and are critical drivers towards making Kenya an

industrialized country with high quality of life for its citizen. Mulwa (2014) states that the small and medium size enterprises present the most dynamic economic foundation for growth, income and employment creation .In Kenya 18% of the GDP and 80% of the workforce population are employed in SMEs, sector according to Kithae (2012). SMEs are seen to provide apparently goods and services at a reasonable price, employment and incomes to a large number of individuals (Kauffmann, 2006). Several research, have been conducted to establish the relationship between economic growth and business development (Harris and Gibson, 2006).

Micro, small and medium sized enterprises are credited to offering about 75% of the general employment and contributing about 18% of GDP in the Kenyan economy. These enterprises cut across all sectors of economy including general trade (wholesale and retail), services, farm activities and manufacturing (Atieno, 2009).

Small and Medium Enterprises in Kenya may exhibit lack of knowledge on financial resources available in the market leading them to choose expensive sources of finance which they are unable to service. It is important to remember that the SMEs hold the key to rapid technological development and full employment (Mokua, 2011). These enterprises offer a means whereby new employment opportunities can be created in rural areas. The small enterprises would not only provide a livelihood but would also create employment for others, thereby easing up social tensions like insecurity growing in an atmosphere where so many are deprived, a scenario to be found in the underprivileged areas of the developing world.

1.2 Statement of the Problem

In almost all economies especially in developing countries SMEs hold the key to rapid technological development and creation of jobs (Mokua, 2011). In the developing world, most jobs are reported to be created by SMEs. .Despite their significance, past statistics indicate that 3 out of 5 SMEs fail within the first few months of operation and those that continue 80 per cent fail before the fifth year (Kenya National Bureau of Statistics, 2007). It is therefore necessary to eliminate the many constraints facing these small businesses, such as wrong capital structure which make their operations unsustainable.

In the developing world, Kenya included more than 90% of new ventures are financed by informal sources of finance and more than 60% of the start-up capital is financed by the business founders (Pretorius, 2007). Despite this unequivocal evidence, it is interesting to note that the vast majority of studies (Wanjohi & Mugure, 2008; Mokua, 2011; Gitari, 2012; Mwangi, 2013; Kenduiwo, 2014; Ndungu, 2014; Kiajage, 2015) focus on the access of finance to the SMEs and no documented evidence of a study on the factors influencing choice of capital structure for SMEs. In most cases, even where credit is available mainly through banks, the SMEs may lack freedom of choice because the bank's lending conditions may force the purchase of heavy, immovable equipment that can serve as collateral for the bank, and lack of freedom of choice forces SMEs to rely on high cost short-term finance, which is detrimental to their day to day operations. Therefore, given the contribution of SMEs to the Kenyan economy, there was need to conduct a study to examine factors influencing their choice of capital structure, hence this study.

1.3 Objectives of the Study

1.3.1 General objective

The general objective of the study was to assess selected factors that influence capital structure for small and medium enterprises in Kiambu County, Kenya.

1.3.2 Specific objectives

- i. To determine the effect of firm size on the capital structure for SMEs in Kiambu County, Kenya.
- ii. To determine the effect of information availability on the capital structure for SMEs in Kiambu County, Kenya.
- iii. To determine the effect of purpose of finance on the capital structure for SMEs in Kiambu County, Kenya
- iv. To determine the effect of cost of finance on the capital structure for SMEs in Kiambu County, Kenya.
- v. To determine the effect of collateral requirement on choice of capital structure for SMEs in Kiambu County, Kenya
- vi. To determine the combined effect of selected factors on the capital structure of SMEs in Kiambu County, Kenya

1.4 Research hypotheses

H₀₁: There is no significant relationship between the size of the firm and capital structure for SMEs in Kiambu County, Kenya.

H₀₂: There is no significant relationship between the availability of information and capital structure for SMEs in Kiambu County, Kenya.

H₀₃: There is no significant relationship between purpose of finance and the capital structure for SMEs in Kiambu County, Kenya.

HO₄: There is no significant relationship between cost of finance and the capital structure for SMEs in Kiambu County, Kenya.

HO₅: There is no significant relationship between collateral requirement and the capital structure for SMEs in Kiambu County, Kenya

HO₆: There is no significant relationship between the selected factors and the capital structure by Small and Medium Enterprises in Kiambu County, Kenya

2.0 Literature Review

2.1 Pecking Order Theory (POT)

The SME financing pattern explained by Berger and Udell (1998) contrasts with the hypothesis given under pecking order theory. The pecking order theory developed by Myers (1984) postulates that, internal sources of funding are prioritized while the use of external sources is delayed until the internal sources are exhausted. As such, when seeking funds, a firm prefers internal equity to external debt, short-term debt to long-term debt, and external debt to external equity. Therefore, the order of preference for the financing sources for a firm should always be as follows: internal equity, issuing debt, and then issuing equity (Padachi & Bhiwajee, 2016).

2.3 Credit Rationing Theory

One of the most important theories that focused on financing gap analysis is the Credit Rationing Theory by Stiglitz and Weiss (1981). In their formulation, they argued that agency problems (a conflict of interest between management (agents) and the shareholders (owners) of the organization) and information asymmetries are the major reason why SMEs have constrained access to finance. They argued that only SMEs know their real financial structure, the real strength of the investment project and the effective intention to repay the debt, that is, firms have superior private information (asymmetric information). Hence, the bank manager makes decisions under asymmetric information, and operates under a moral hazard and adverse selection risk

These concepts on credit rationing theory lay the core foundation for SMES in moving toward making choices of financing because they know their real financial structure, the real strength of the investment project and the effective intention to repay the debt. This theory therefore depicts that the SMEs should align its choices in terms of cost of financing, purpose of the finance and information availability that it will give it an opportunity to realize its best choice of financing.

2.4 Factors Influencing Capital Structure of Smes.

2.4.1 Size of the Firm

Even though there is no consensus amongst researchers about the criteria that should be employed to measure the size of the firm (typically total assets, sales or the number of employees), the notion that firm size has an effect on SMEs activities and its potential to expand appears to receive general agreement. A firm's size is usually coupled with its age as they tend to have similar influence on the firm's life cycle. This influence can be strongly observed in the decision making process in the firm about whether one particular sort or another of finance should be chosen and utilized (van Binsbergen, Graham & Yang, 2010). Studying firms financing and capital structure using a sample consisted of 292 Australian firms, Nazir and Afza (2010) concluded that the "larger" small firms are, the more they rely on long-term debt and external financing, including bank loans.

2.4.2 Availability of Financial Information

The higher the level of information asymmetry, the higher the perceived risk, the less the likelihood of adopting a particular source of finance. In scenarios where firms have to make a choice, then that ranges from low risk to high risk capital sources as dictated by the availability of information sources (Myers and Majluf, 2011). As also seen earlier, the existence of information asymmetries between the firm and likely finance providers causes the relative costs of finance to vary between the different sources of finance (Butler, P. & Durkin, 2008). Due to asymmetries of information between insiders and outsiders, the company will prefer to be financed first by internal resources, then by debt and finally by stockholders' equity, in this 'pecking' order.

Wanjohi (2010) conducted an empirical study relating Kenyan manufacturing SMEs' finance needs to information on alternative sources of finance. The empirical evidence suggested that the majority of the SMEs operators in Kenya were not aware of certain sources of finance. Apart from a lack of knowledge on what they were, it was acknowledged by some respondents that it was difficult to obtain information on them. The findings indicate that the general knowledge and awareness of finance options available to SMEs in Kenya was poor. This was due to a lack of understanding of what is available due to fragmented financial information and a lack of targeted awareness and educational schemes with a view to raising the profile of finance issues among the SMEs. A failure to increase awareness of the finance options may result in the inappropriate usage of finance and misconceptions on finance availability for SMEs.

The empirical results indicate that there was an information gap in SMEs financing, that is, the necessary knowledge on finance sources was lacking. The respondents felt that they had difficulties knowing where to

access business finance. They needed information and knowledge on alternative sources of finance applicable to their situation, be they freely available in the public domain or only accessible at a price. There are numerous types of finance available to SMEs in Kenya. However, their details are very fragmented and it is very difficult to identify: What finance options are currently available; which option(s) is (are) most appropriate; the restrictions for an application; and how to apply these; this study will attempt to shed light on some of these aspects (Wanjohi, 2010).

2.4.3 Cost of finance

The cost of capital is a term used in the field of financial investment to refer to the cost of a company's funds (both debt and equity), or, from an investor's point of view "the shareholder's required return on a portfolio of all the company's existing securities" (Khale & Ren'e, 2013). It is used to evaluate new projects of a company as it is the minimum return that investors expect for providing capital to the company, thus setting a benchmark that a new project has to meet. As such, in studying the financing options of start-ups, many factors other than the direct cost of funds may influence the financing decisions of both financier and entrepreneur.

Internal sources are often preferable to a firm as they will usually be cheaper and perhaps easier to arrange at short notice (Brijlal, Enow & Isaacs, 2014). However, the potential for arranging large amounts of finance may be low. The main internal sources are profits and savings from reduced working capital. Failure of the firm may lead to personal bankruptcy as well. Khale and Ren'e (2013) also noted that most small firm owners have undiversified personal portfolios; all of their assets and wealth are tied up in the firm. To make matters worse, the firm is typically their employer and may also employ other members of the family. If the firm fails, the entrepreneur, in addition to his friends and relatives, lose not only their wealth but their jobs as well. This lack of diversification adds to the riskiness of operating an entrepreneurial venture.

2.4.4 Collateral Requirements

Historical development and the associated culture, of the banking system underpin the problem of the emphasis on the provision of collateral as a primary condition in lending. Banks have always adopted a risk adverse stance towards small firms, with an accompanying inability to focus on the income generating potential of the venture, when analyzing the likelihood of loan repayment (Brick & Palia, 2007). Credit constraints can occur when banks increase collaterals for loans. As a result, low interest borrowers (including MSEs) may be removed from the list of potential customers and banks may skip these customers (Bae & Goyal, 2009). Gangata and Matavire (2013) in their study on challenges facing MSEs in accessing finance from financial institutions, found out that very few MSEs succeed in accessing funding from financial institutions, the main reason being failure to meet lending requirements, chief among them being provision of collateral security.

3.0 Research Methodology

3.1 Target population

The population of interest is composed of all SMEs in Kiambu County registered in the Kiambu Business Directory (KBD) 2015. (Kiambu Business Directory is the official County Government register of all businesses in Kiambu County.) There is a total of approximately 889 SMEs belonging to different sectors; manufacturing has 113, agricultural has 226, essential services that include private schools and health facilities have 217, general merchandise like shops and supermarkets have 106, commercial services and other service industries are a total of 227 (see table 3.1 below).

Table 1

Sector	Number
Manufacturing	113
Agricultural	226
Essential Services	217
General Merchandise	106
Commercial & Other Services	227
Total	889

Source: Researcher (2015)

3.2 Sample size and sampling technique

According to Mugenda and Mugenda (1999) the sample size for a population of 10,000 or more can be computed as per the formula below:

$$n = \frac{pqz^2}{e^2}$$

Where, n = Minimum Sample Size

p = Population proportion with given characteristic

q = 1-p

z = Standard normal deviate at the required confidence level

e = Error Margin

Mugenda and Mugenda (1999, as contained in Fisher, Laing and Styoeckel, 1983) recommend that since p and q are unknown, both are set at 50%. A confidence level of 95% will be used for this study, $z = 1.96$ and the sampling error of $e = \pm 5\%$.

$$n = 1.96^2 \times 0.5 \times 0.5 / 0.05^2 = 384$$

For a population less than 10,000 which is the case in this study the sample size is computed as per the formula $nf = n / (1 + n/N)$. Where N is the target population (889) and n is the typical sample size for a population of more than 10,000 (which is 384 as calculated above).

Thus, sample size nf becomes $384 / (1 + 384/889) = 268$

The formula for arriving at the proportionate samples is

Proportionate sample = Target sample/ Total population x sample size (268)

The proportionate distribution is as shown in table 3.2 below.

Table 2: Sampling distribution

Sector	Number	Proportionate Sample
Manufacturing	113	34
Agricultural	226	68
Essential Services	217	65
General Merchandise	106	32
Commercial & Other Services	227	68
Total	889	268

3.3 Data collection methods and procedures

Primary data were collected from interview schedules using questionnaires, whereas the secondary data were collected from existing written materials such as journals, theses, books, pamphlets, among others. The questionnaire consisted of both closed ended and open ended questions and was administered to the respondents directly by the researcher with the help of research assistants.

The questionnaire contained demographic factors in the first part while the main body of the questionnaire focused on factors that influence capital structure for Small and Medium Size Enterprises, each respondent was asked to rate or rank the responses on a Likert scale. Secondary data from research reports and previous studies were used to provide a wider understanding of the issues under study.

3.4 Results and Discussion

Reliability Test

All the questions with ranking 1-5 on a Likert scale were tested on SPSS and the reliability coefficient of the research instrument with Cronbach's alpha (α) was found to be 0.798 (0.8) as indicated in the table below.

Table 3 : Reliability Tests

Cronbach's Alpha	Cronbach's Alpha Based on Standardized Items	N of Items
.789	.798	45

3.5 The Capital Structure of SMEs

To establish the extent of utilization of particular sources the respondents were asked to rate on a Likert scale, where 1=Not at All (NA), 2=Small Extent (SE), 3=Moderate (M), 4=Great Extent (GE), and 5=Greatest Extent (GSE). The mean (M) and Standard Deviation (SD) are also indicated as in the table below.

Table 4: Extent of utilization of particular source of capital

Statement	Percentage					M	SD
	NA	SE	M	GE	GSE		
Personal savings	-	4.1	15.7	37.3	42.9	4.19	0.0846
Family/ relatives borrowing	1.1	22.4	41.8	24.6	10.1	3.20	0.938
Bank loan	41.8	22.4	11.9	-	-	2.39	0.745
SACCOs	33.6	19.4	35.4	7.1	4.5	2.29	1.138
ROSCAs	8.6	26.5	32.5	18.7	13.8	3.03	1.162
MFIs	3.4	6.3	38.1	37.3	14.9	3.54	0.937
Government Agencies	26.1	30.2	25.0	13.1	5.6	2.42	1.170

From the table above, the respondents had used personal savings to a great extent and greatest extent at 37.3% and 42.9% respectively. This finding is consistent with Pecking Order Theory (Berger & Udell, 1999) and Mokua (2011) on a study on credit financing by SMEs in Kisii County who observed that most SMEs would rather exhaust personal savings than borrow from finance institutions. The respondents had utilized family/

relatives savings to support their businesses at a moderate level (41.8%), followed by those who used it to great extent (24.6%) and those who utilized to a small extent (22.4%).

Majority (41.8%) of the respondents had not utilized bank loans, whereas to a small extent (22.4%), and moderate (11.9%). However, a reasonable percentage (23.9%) of the respondents did not indicate whether they had utilized bank loans. These finding tallies with a study carried in Murang'a County by Ndungu (2014) that despite availability of information on bank loans most SMEs were reluctant to borrow due to stringent requirements by the banks. The respondents had utilized SACCOs to get finances for their businesses to moderate (35.4%), and small extent (19.4%). However, 33.6% had not utilized them at all. This compares to those who utilized to great extent (7.1%) and greatest extent (4.5%).

Majority (32.5%) of the respondents had used merry-go-round to finance their businesses, whereas 26.5% used to a small extent, 18.7% to a great extent, and 13.8% to greatest extent. The respondents sought financing from micro-finance institutions to moderate (38.1%) and great extent (37.3%) respectively; 14.9% utilized to greatest extent, whereas a paltry 3.4% did not borrow at all. Borrowing from government agencies were utilized to a small extent (30.2%) and moderate extent (25.0%); 26.1% did not utilize at all compared with those who used them to great extent (13.1%), and greatest extent (5.6%). This is mainly due to group guarantees required by Government finance agencies.

3.6 Type of business

From table 4.6 below, Majority of the businesses were both service and trade companies at 49.6% followed by those combining service, trade and manufacturing at 26.9%. Firms dealing in manufacturing only were 14.9%, trade 7.5%, and service 1.1%. The firms had total assets ranging from KES 100,000 to KES 5,000,000; average monthly gross profit in the last five years of between KES 30,000 to KES 150,000 and had between 1 and 5 branches. The finding is in line with the definition of an SME by Kenya Association of Manufacturers (1999).

Table 5: Type of business

	Frequency	Percentage	Mean	Standard Deviation
Service	3	1.1		
Trade	20	7.5		
Manufacturing	40	14.9		
Service and trade	133	49.6		
Service, trade, and manufacturing	72	26.9		
Total	268	100.0	3.94	0.903

3.7 Size of The Firm

This section deals with how indicators of the size of the firm influence their capital structure, as one of the objectives of the study. The findings as indicated below confirm that size of the firm influences choice of capital structure of SMEs and agree with the findings from a study conducted in Cameroon by Ngenhevu (2010).

3.8 Extent of influence of size of the firm

To determine the extent of the influence of size of the firm on choice of capital structure the respondents were asked to rate the statements on a Likert scale, where 1=Strongly Disagree (SDA), 2=Disagree (DA), 3=Neutral (N), 4=Agree (A), and 5=Strongly Agree (SA). The mean (M) and Standard Deviation (SD) are also indicated as in the table below.

Table 6: Size of the firm

Statement	Percentage					M	SD
	SDA	DA	N	A	SA		
Number of employees	1.9	13.8	22.4	39.9	22.0	3.66	1.027
Gross profit	1.9	17.9	24.3	29.9	26.1	2.40	1.112
Age of business	4.1	6.3	22.0	33.6	34.0	3.87	1.082
Annual average turnover	7.1	11.9	26.1	33.2	21.6	3.50	1.163
Expansion of the firm	11.2	15.7	17.5	26.1	29.5	3.47	1.353

From the table above, thirty-nine point nine percent (39.9%) of the respondents agreed that the number of employees in a firm influenced its choice of capital structure. This was followed by those who were not sure at 22.4%, those who strongly agreed 22.0%, and those who disagreed 13.8%. The respondents agreed (29.9%) and strongly agreed (26.1%) that gross profit influenced choice of capital structure, compared with those who were not sure (24.3%), disagreed (17.9%) and strongly disagreed (1.9%). A larger percentage of the respondents strongly agreed (34.0%) and agreed 33.6 % that the age of the business influenced where they got financing. This was followed by those who were not sure at 22.0%. According to Nyarige (2014) younger enterprises are

more reliant on informal financing and far less on bank financing.

Similarly, 33.2% of the respondents agreed and 21.6% strongly agreed that annual average in sales turnover influenced capital structure. This compares favourably with those who were not sure and disagreed at 26.1% and 11.9% respectively. According to the respondents who agreed (26.1%) and agreed strongly (29.5%) expansion of the business in terms of number of branches influenced where financing was secured. However, 15.7%, 11.2%, and 17.5% disagreed, disagreed strongly and were not sure respectively. This agrees with earlier observation of size of the business, as the more the branches the bigger the size.

3.9 Influence of size of business on capital structure

Overall, the size of the business influenced the capital structure of the firms to great extent (33.6%) and to greatest extent (33.6%) respectively compared with those who were not sure at 18.7% as illustrated in the table below.

Table 6: Influence of size of business on capital structure

	Frequency	Percentage	Mean	Standard Deviation
Not at all	13	4.9		
Small extent	25	9.3		
Moderate	50	18.7		
Great extent	90	33.6		
Greatest extent	90	33.6		
Total	268	100.0	3.82	1.142

3.10 Availability of information

Availability of information on range of capital structure options is one of the objectives of the study. This section therefore focuses on awareness of various sources of finance, knowledge about capital structure options, reliability, sources of information and restrictions imposed on them.

To find out the extent of influence of availability of information on capital structure the respondents were asked to rate on a Likert scale, where 1=Not at All (NA), 2=Small Extent (SE), 3=Moderate (M), 4=Great Extent (GE), and 5=Greatest Extent (GSE). The mean (M) and Standard Deviation (SD) are also indicated as in the table below.

Table 7: Availability of information

Statement	Percentage					M	SD
	NA	SE	M	GE	GSE		
Awareness of various sources	0.4	3.7	12.3	37.3	46.3	4.25	0.841
Knowledge of financing options	3.4	5.2	7.8	47.4	36.2	4.08	0.974
Appropriateness of choices	8.6	18.7	22.0	38.4	12.3	3.27	1.157
Restrictions on information	11.9	6.3	16.8	39.2	25.7	3.60	1.225
Methodologies of application	26.1	31.0	20.1	16.0	6.7	2.46	1.225
Reliability of information	14.9	18.3	17.5	32.5	16.8	3.18	1.323
Influence of information availability	1.1	2.6	14.6	36.2	45.5	4.22	0.871

From the table above, awareness of various sources of finance influence capital structure of SMEs to great extent (37.3%) and greatest extent (46.3%). Those who were not sure were 12.3%. Knowledge of financing options influence choice of capital structure to great extent (47.4%) and greatest extent (36.2%) respectively. A small percentage 3.4%, 5.2%, and 7.8% said that it did not influence, it influenced to small extent, and were not sure respectively. Thirty-eight point four percent (38.4%) of the respondents said that appropriateness of various finance options influenced their choice of capital structure. This was followed by 22.0% who indicated moderate influence and those who said that it influenced to a small extent (18.7%).

Restrictions of various finance options influenced choice of capital structure by the respondents to a great extent (39.2%) and greatest extent (25.7%) respectively. The methodologies of application did not influence choice of capital structure and influenced only to a small extent at 26.1% and 31.0% respectively. They also influenced to moderate extent and great extent at 20.1% and 16.0% respectively. Majority (32.5%) of the respondents indicated that reliability of information sources influence capital structure to great extent. This was followed by those who indicated small extent (18.3%) and greatest extent (16.8%).

3.11 Purpose of Finance

To determine the extent of influence of purpose of finance on choice of capital structure the respondents were asked to rate on a Likert scale, where 1=Not at All (NA), 2=Small Extent (SE), 3=Moderate (M), 4=Great Extent

(GE), and 5=Greatest Extent (GSE). The mean (M) and Standard Deviation (SD) are also indicated as in the table below.

Table 8: Extent of purpose of finance

Statement	Percentage					M	SD
	NA	SE	M	GE	GSE		
Working capital requirements	6.3	11.6	20.1	32.1	29.9	3.68	1.197
Acquiring assets	7.5	18.7	18.3	25.4	30.2	3.52	1.297
Expansion of firm	43.7	40.3	9.3	5.2	1.5	1.81	0.916

From the table above, to a great extent (32.1%) and greatest extent (29.9%) meeting working capital requirements was given as the greatest influence on capital structure. However, a significant percentage (20.1%) was not sure. Amidu (2007) observes that meeting working capital requirements is the most consequential purpose of choosing certain capital structure by SMEs. The respondents indicated that acquiring assets influenced their choice of capital structure to great extent (25.4%) and greatest extent (30.2%). However, a significant majority indicated to a small extent (18.7%) and were not sure (18.3%) respectively. Expansion of the business did not influence choice of capital structure according to the respondents who indicated not at all (43.7%) and small extent (40.3%).

Overall, the purpose of finance influenced choice of capital structure to a great and greatest extent according to 39.9% and 47.8% of the respondents as in the table below. This agrees with the findings of Niskanen (2010).

3.12 Collateral requirements

Most creditors require collateral security before they extend financing to SMEs. This section demonstrates how collateral requirements influenced the choice of capital structure of SMEs in Kiambu County.

To establish the extent of influence of collateral security on the choice of capital structure the respondents were asked to rate on a Likert scale, where 1=Not at All (NA), 2=Small Extent (SE), 3=Moderate (M), 4=Great Extent (GE), and 5=Greatest Extent (GSE). The mean (M) and Standard Deviation (SD) are also indicated as in the table below.

Table 9: Extent of utilization of collateral security

Statement	Percentage					M	SD
	NA	SE	M	GE	GSE		
Group guarantees	44.8	38.8	9.3	4.5	2.6	1.81	0.961
Individual guarantors	51.1	32.5	10.8	3.4	2.2	1.73	0.941
Assets (title deeds/ log books)	3.7	9.0	19.0	33.2	35.1	3.87	1.106
Equity capital	10.1	16.8	18.3	25.4	29.5	3.47	1.336

From the table above, majority of the respondents did not utilize group guarantees as collateral requirement in their choice of capital structure according to 44.8% and 38.8% of the respondents who indicated not at all and small extent respectively. Mokuu (2011) observes similarly that one of the inhibitions towards expansion of SMEs is lack of collateral requirements. Similarly, individual guarantors were less utilized as a collateral requirement in choice of capital structure according to 51.1% and 32.5% of the respondents. A small percentage (10.8%) of the respondents was not sure.

Assets, especially title deed and vehicle logbook, were widely used by the respondents as collateral requirement in their choice of capital structure according to 33.2% and 35.1% of the respondents who indicated great extent and greatest extent respectively. In addition, equity capital was utilized as collateral according to 25.4% and 29.5% of the respondents who indicated great extent and greatest extent respectively. However, a fair majority indicated moderate (18.3%), small extent (16.8%), and not at all (10.1%).

Similarly, to determine the role of particular collateral security the respondents were asked to indicate as in the table below.

Table 10: Use of collateral security

Statement	Percentage							M	SD
	Personal savings	Friends/ relatives borrowing	Bank loan	SACCOs	ROSCAs	MFIs	Government Agencies		
Group guarantees	-	0.7	2.2	4.9	2.6	3.7	85.8	6.64	0.998
Individual guarantors	-	-	5.2	5.2	7.8	39.9	41.8	6.08	1.083
Equity capital	5.2	4.1	53.0	3.7	-	29.9	4.1	3.95	1.654

From the table above, group guarantees were used to borrow from governments agencies according to 85.8% of the respondents. Individual guarantors were used to borrow from micro-finance institutions and government agencies according to 39.9% and 41.8% of the respondents respectively. Similarly, equity capital was used to borrow from banks and micro-finance institutions according to 53.0% and 29.9% of the respondents.

3.13 Cost of Finance

A significant majority (98.1%) of the SMEs considered the cost of accessing and procuring finance in their choice of capital structure.

Table 11: Did you consider cost in your choice of capital structure?

	Frequency	Percent	Mean	Standard Deviation
Yes	263	98.1		
No	5	1.9		
Total	268	100.0	1.02	0.136

This finding agrees with Kinyanjui (2004), Mwangi (2013), and Kenduiwo (2014). Most consideration was put on interest on loans, application procedures and fees levied, or default risks such as auctioning of assets.

Table 12: Cost considerations

	Frequency	Percent	Mean	Standard Deviation
Interest rates	68	25.4		
Insurance fees	23	8.6		
Negotiation fees	47	17.5		
Legal fees	50	18.7		
Processing fees	80	29.9		
Total	268	100.0	3.19	1.567

From the study findings, more emphasis was put on SACCOs (63.4%) because they had low risks in the event of defaults as discussed below.

Table 13: Which capital structure source was more affordable?

	Frequency	Percent	Mean	Standard Deviation
SACCOs	170	63.4		
Family/ relatives	40	14.9		
MFIs	5	1.9		
Bank loan	12	4.5		
ROSCAS	18	6.7		
Government agencies	23	8.6		
Total	268	100.0	2.02	1.679

This signifies that majority of the SMEs proprietors even if they are not members of SACCOs aspire to join them.

3.14 Correlation analysis

A correlation analysis was conducted for this study to determine whether there existed any relationship between the study variables. The findings show that on average the independent variables showed strong positive relationship with the dependent variable (capital structure) as shown in table 4.18 below. There was strong positive correlation between availability of information ($r=0.780$, $p<0.01$), purpose of finance ($r=0.906$, $p<0.01$), size of the business ($r=0.916$, $p<0.01$), and collateral security ($r=0.671$, $p<0.01$). However, there was weak positive correlation between cost ($r=0.132$, $p<0.05$) and choice of capital structure. This means that at 1% and 5% level of significance all the independent variables availability of information, size of the firm, purpose of finance, cost of financing, and collateral security determined choice of capital structure of SMEs in Kiambu County.

Table 14.: Correlation matrix

		Capital structure	Influence of size of business on capital structure	Availability of information sources	Influence of purpose of finance on capital structure	Collateral security	Cost of capital structure
Capital structure	Pearson Correlation	1	.916**	.780**	.906**	.671**	.132*
	Sig. (2-tailed)		.000	.000	.000	.000	.031
	N	268	268	268	268	268	268
Influence of size of business on capital structure	Pearson Correlation	.916**	1	.832**	.895**	.665**	.143*
	Sig. (2-tailed)	.000		.000	.000	.000	.019
	N	268	268	268	268	268	268
Availability of information sources	Pearson Correlation	.780**	.832**	1	.693**	.905**	.329**
	Sig. (2-tailed)	.000	.000		.000	.000	.000
	N	268	268	268	268	268	268
Influence of purpose of finance on capital structure	Pearson Correlation	.906**	.895**	.693**	1	.632**	.115
	Sig. (2-tailed)	.000	.000	.000		.000	.061
	N	268	268	268	268	268	268
Collateral security	Pearson Correlation	.671**	.665**	.905**	.632**	1	.480**
	Sig. (2-tailed)	.000	.000	.000	.000		.000
	N	268	268	268	268	268	268
Cost of capital structure	Pearson Correlation	.132*	.143*	.329**	.115	.480**	1
	Sig. (2-tailed)	.031	.019	.000	.061	.000	
	N	268	268	268	268	268	268

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

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

3.15 Regression Analysis

The relationship between selected factors and choice of capital structure of SMEs was tested through a regression analysis. The results presents the regression model summary in table 4.49 which gives the coefficient of determination showing the extent to which the predictor variables influences the dependent variable, the analysis of variance in table 4.50 which determines the reliability of the model developed in explaining the relationship and the regression coefficients in table 4.51 which gives the coefficient explaining the extent at which the independent variables influence the dependent variable.

The coefficient of determination (R square value) from the table is 0.883. This indicates that, the variability in the choice of capital structure by SMEs is 88.3% explained by the independent variables. This being the case, therefore, the variability due to other factors which were not studied in the current research is 11.7%. From the table also, the adjusted R square is 0.881 which measures the reliability of the results. Thus, the study results are 88.1% reliable and therefore the model results are significant and reliable in explaining the influence of the predictor variables to the dependent variable.

Table 15: Regression Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.940 ^a	.883	.881	.292

a. Predictors: (Constant), Collateral security, Cost of capital structure,

Influence of purpose of finance on capital structure, Influence of size of business on capital structure, Availability of information sources

The table below presents the F statistic which is used to test the significance of the model on relationship between the depended and the independent variables. The F value in the table is 395.065. Therefore, there is strong evidence that the regression model developed was reliable and statistically significant at 0.000 which is less that of p-value 0.050 and that the variation in the results is insignificant. It is clear from the results that the relationship between the variables is statistically significant.

Table 16: Analysis of Variance ANOVA^a

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	168.893	5	33.779	395.065	.000 ^b
	Residual	22.401	262	.086		
	Total	191.295	267			

a. Dependent Variable: Capital structure

b. Predictors: (Constant), Collateral security, Cost of capital structure, Influence of purpose of finance on capital structure, Influence of size of business on capital structure, Availability of information sources

The table below gives the regression coefficients which was used to test the regression model; $Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \epsilon$ Where: Y = choice of capital structure X_1 = size of business X_2 = availability of information X_3 = cost of finance X_4 = purpose of finance X_5 = collateral security β_0 = Constant ϵ = standard error

Based on the table results, the model therefore becomes;

$$Y = 1.029 + 0.262X_1 + 0.129X_2 + 0.147X_3 + 0.477X_4 + 0.015X_5 + 0.202$$

Table 17: Regression coefficients^a

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	1.029	.202		5.098	.000
size of business	.262	.061	.353	4.295	.000
Availability of information	.129	.066	.176	1.951	.042
Cost of financing	-.147	.161	-.024	-.913	.036
purpose of finance	.477	.059	.482	8.075	.000
Collateral security	-.015	.064	-.016	-.228	.019

a. Dependent Variable: Capital structure

From the model, it is clear that size, availability of information, purpose of finance were positively related to the choice of finance while cost of financing and collateral were negatively related to the choice of capital structure. A unit increase in selected factors would result to 1.029 times change in the choice of capital structure of the SMEs. At 95% confidence level all coefficients were found to be significant as indicated by their p-values which were less than 0.050 (the critical value at 5% level) except for availability of information.

3.16 Hypothesis Testing

The researcher sought to test the hypotheses by regressing selected factors against choice of capital structure. Below are the results.

The first hypothesis H_{01} : There is no significant relationship between the size of the firm and choice of capital structure for SMEs in Kiambu County, Kenya. The significance was 0.00, which was less than the p-value 0.05 with $t=4.295$. Therefore, the null hypothesis was rejected implying that there is significant relationship between the size of the firm and choice of capital structure of SMEs in kiambu

The second hypothesis H_{02} : There is no significant relationship between the availability of information and the choice of capital structure financing for SMEs in Kiambu County, Kenya. The significance t-value was 0.042, which was less than the p-value 0.05 with $t=1.951$. Therefore, the null hypothesis was rejected. This mean there is a significant relationship between the availability of information and choice of capital structure financing for SMEs in Kiambu County, Kenya

The third hypothesis H_{03} : There is no significant relationship between purpose of finance and the choice of capital structure for SMEs in Kiambu County, Kenya. The significance was 0.000, which was less than the p-value 0.05 with $t=-0.913$. Therefore, the null hypothesis was rejected. This indicates that: There is significant relationship between the purpose of finance and the capital structure for SMEs in Kiambu County, Kenya

The fourth hypothesis H_{04} : There is no significant relationship between cost of finance and the choice the capital structure for SMEs in Kiambu County, Kenya. The significance of the value was 0.036, which was less than the p-value 0.05 with $t=8.075$. Therefore, the null hypothesis was thus rejected.

The fifth hypothesis H_{05} : There is no significant relationship between collateral requirement and the capital structure for SMEs in Kiambu County, Kenya. The significance of the t value was 0.019, which was greater than the p-value 0.05 with $t=-0.228$. Therefore, the null hypothesis was rejected.

Finally, hypothesis six which is a summary of all the hypotheses H_{06} : There is no significant relationship between the selected factors and the capital structure by Small and Medium Enterprises in Kiambu County, Kenya. The F value in the table was 395.065. Therefore, there is strong evidence that the regression model developed was reliable and statistically significant at 0.000 which is less than of p-value 0.050 and that the

variation in the results is insignificant. Therefore, the null hypothesis was rejected implying that the selected factors affect the capital structure of Small and Medium Enterprises in Kiambu County, Kenya.

3.17 Conclusion

The study concludes that Firm Size, Information Availability, Purpose of Finance, Cost of Finance and Collateral Requirements have significant effect on the choice of capital structure for SMEs in Kiambu County, Kenya. The study recommends that the Government should introduce targeted legislation that ensures universal access to information, favorable interest rates and flexible repayment period for SMEs.

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