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Access to Finance and Performance of SMEs in Lodwar Municipality

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Abstract

Purpose: To establish the effect of access to finance on performance of SMES in Lodwar Municipality

Methodology: The research adopted a descriptive design. The target population for this study comprised of SMEs owners/managers. The study relied on primary data, which was obtained directly from respondents. Data collection was conducted through the use of structured questionnaires, specifically tailored to capture information relevant to the study variables from SMEs in Lodwar Municipality. Questionnaires were selected as the preferred tool due to their efficiency in collecting uniform responses from a relatively large sample.

Findings: The findings indicate a strong positive correlation between access to financing and the performance of small and medium-sized enterprises (SMEs). This implies that as SMEs gain better access to financial resources, their overall performance improves significantly

Unique Contribution to Theory, Practice and Policy: Policymakers, financial institutions, and development partners should therefore prioritize interventions that lower borrowing barriers, provide affordable credit and strengthen financial literacy among entrepreneurs. By addressing the financing gap, such efforts would not only boost the productivity and profitability of SMEs but also contribute to broader economic development through increased employment, innovation, and income generation.

Keywords: *SMEs, Access to Finance, Performance*

JEL Classification Code: *G21, L25, L26*

INTRODUCTION

Small and Medium-sized Enterprises (SMEs) are vital engines of economic growth, innovation and employment generation, particularly in developing economies. In Kenya, SMEs constitute over 90% of all businesses and employ approximately three-quarters of the country's labor force, significantly contributing to the Gross Domestic Product and poverty reduction efforts. Despite their immense potential, SMEs in emerging markets often grapple with a myriad of challenges that impede their growth and sustainability. These impediments commonly include limited access to finance, inadequate managerial capabilities, and complex socio-cultural environments that can either foster or hinder entrepreneurial endeavors. According to the Kenya's Economic Survey (2020), SMEs constitutes about 98% of businesses in the country. The employment generated by these SMEs stands at about 80% yearly. Moreover, these SMES contributes about 18.4 % towards Gross Domestic Product which is a good indicator justifying the important part played by these enterprises. It should be noted that SMEs stabilizes the goods and services conditions, as well as drives competition, thus building the entrepreneurship atmosphere that is much needed condition for private sector expansion and increased industrialization in a functional economy (Berge, 2013).

The Kenyan government projects that its economy would be transformed into an industrialized economy by the year 2030. More importantly, it acknowledges the significant role SMEs would play in driving this transformation process. However, in reality, SMEs in Kenya exhibit characteristics of being small in size, employing no more than 5 people, and having an increased exit rate, which hinders their growth into large enterprises GOK (2012), Vision 2030. Given these characteristics, it is evident that many SMEs struggles to succeed due to numerous challenges among them limited access to finance. In fact, a considerable proportion of enterprises in Kenya collapses within the first few months of inception, whilst those that manage to persist experience a substantial failure rate of 80% before reaching their fifth year. These challenges are attributed to factors such as limited financial accessibility, inadequate management competencies, and an unfavorable business environment (Kenya Manufacturing Association, 2021). Dahir (2015) indicates that Kenyan SMEs faces several obstacles that hinder their risk management and growth. Notably, many SMEs encounters difficulties in obtaining financing. This is primarily because these businesses often lack the necessary creditworthiness and managerial capacity, making financial institutions hesitant to provide them with loans due to the perceived higher credit risk involved. Consequently, these concerns result in their rejection by commercial banks and other lenders when seeking loans, primarily due to their poor financial records, inability to meet collateral requirements, and weak management structures. The Kenya Economic Outlook report indicates that inadequate capital, as well as insufficient knowledge and skills, slows down the growth of SMEs in Kenya. Kithae, Gakure, and Munyao (2012) indicates that financial limitations, inadequate infrastructure, and restricted market access impede the development of SMEs, especially in rural regions.

This study focused on the context of Lodwar Municipality in Turkana County, a region characterized by unique socioeconomic dynamics and a nascent but growing SME sector comprising diverse businesses such as clothing outlets, clinics, restaurants, butcheries and retail shops. Understanding the specific factors influencing SME performance in this distinct setting was deemed crucial for fostering local economic development and improving livelihoods. This research aimed to evaluate the extent to which access to finance, managerial skills and the risk management culture of entrepreneurs influence the performance of SMEs in Lodwar Municipality. By examining these critical socioeconomic factors, the study sought to provide

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valuable insights for entrepreneurs, policymakers and financial institutions to formulate targeted interventions that enhance the resilience and competitiveness of small and medium enterprises in the region, thereby contributing to sustainable economic progress.

Problem Statement

Small and medium-sized firms (SMEs) are commonly considered as key drivers of economic prosperity, innovation, and creation of employment, particularly in the developing world. In Kenya, SMEs contribute around 33% to the GDP and account for over eighty percent of job opportunities (Kenya National Bureau of Statistics (KNBS, 2016). Despite their central role in economic advancement, the sector faces persistent structural and operational challenges that significantly undermine business continuity and growth. Alarmingly, KNBS (2013) reported that over 60% of small businesses in Kenya fail within their first 3 years of kickstarting the business.

The Government of Kenya has recognized this trend and, through policy frameworks such as the Kenya Vision 2030 and the Medium-Term Plans, has prioritized SME development as a key strategy for poverty alleviation, self-employment, and economic resilience (Government of Kenya (GOK), 2021). However, empirical evidence suggests that these efforts have yielded limited success. A combination of factors including restricted access to affordable finance, inadequate entrepreneurial and managerial competencies, limited market integration, and a lack of supportive infrastructure continues to inhibit the performance of SMEs (Kinyua, 2020; Mugo, 2016; Rotich, 2014). Furthermore, SMEs often struggle to transition from informal to formal status, depriving them of regulatory protections and institutional support.

Ramsden (2010) emphasizes that SMEs thrive in ecosystems characterized by transparent governance, robust infrastructure, predictable policy environments, and strong institutions. Yet, these conditions are often absent in marginalized and arid regions of Kenya such as Turkana County, where economic and social development have historically lagged behind. Here, SMEs remain the dominant form of enterprise but operate under compounded constraints, including geographic isolation, underdeveloped infrastructure, insecurity, and limited public and private investment.

A United Nations Human Settlements Programme (UN-Habitat, 2022) survey in Turkana County found that 60% of SMEs failed within two years of establishment. Additionally, 28.5% of surveyed SMEs reported poor performance, while 44% were categorized as below average in terms of growth and profitability. Other Contributing factors included lack of start-up capital, absence of entrepreneurial mentorship, limited adoption of technology, and low innovation capacity. These enterprises tend to cluster in low-barrier, traditional sectors such as small-scale retail and crafts, which offer limited prospects for value addition or scalability.

Despite increasing research on SMEs in Kenya, existing studies tend to generalize findings without fully accounting for the geographic and socio-economic diversity of the country. The unique challenges facing SMEs in remote and underdeveloped counties like Turkana remain underexplored in empirical literature. Studies such as Dahir (2015) in Wajir County highlighted financing and capacity-building constraints facing SMES, though they failed to contextualize the broader development disparities and localized business environments.

Therefore, from the above, there seems to be a knowledge gap that warrants this research which seeks to examine the relationship between access to fiancé and SMES performance in Lodwar Municipality, Turkana Central Sub-County. By focusing on region-specific barriers such as financial access, managerial competencies, and cultural dynamics, the study aims to generate insights that can inform tailored policy interventions and practical support mechanisms to enhance SME resilience, formalization, and sustainable growth in marginalized areas.

LITERATURE REVIEW

The Resource-Based View

The Resource-Based View (RBV), introduced by Wernerfelt in 1984, spotlights the pivotal role of internal resources in increasing the effectiveness of the operations and sustaining a firm's competitive advantage. The theory posits that firms can outperform competitors by leveraging unique assets that are not easily replicable. As observed by Mahoney and Pandian (1992), strategic resource management that deters imitation is essential for maintaining long-term advantage. Further, the RBV asserts that to attain sustainable competitive advantage, have resources that are uncommon, precious, unique, non-tradable, and non-substitutable and specific to the organization (Barney, 2010).

The authors investigated how a business may use its unique and valuable resources to gain a long-term competitive edge. Acquiring, transferring, or replicating these resources is no easy task, but they greatly contribute to the firm's success due to their rarity. One critique of the RBV is that it has been accused of not fulfilling the necessary criteria for a genuine theory. Some critics have raised concerns about the RBV, suggesting that it may lack the desired level of generalizations typically found in a theory. Despite its strengths, RBV's applicability in informal or subsistence-based SME environments has been questioned due to its assumption of rational strategic management (Kraaijenbrink, 2009).

This study adopts RBV as a key theoretical lens to look into how socioeconomic variables affect SMEs' success. The RBV underscores the significance of internal resources and firm-specific capabilities in shaping competitive advantage and overall success. Critical resources including financial capital, human capital, and social networks receive special emphasis in keeping with the study's goal of examining the variables influencing SME success. Through applying the RBV framework, the study investigates how SMEs in Lodwar Municipality strategically acquire, utilize, and manage these resources. The research further contextualizes these dynamics within the socio-economic environment of Lodwar, offering a deeper understanding of the internal and external factors driving SME performance in the region.

Contingency Theory

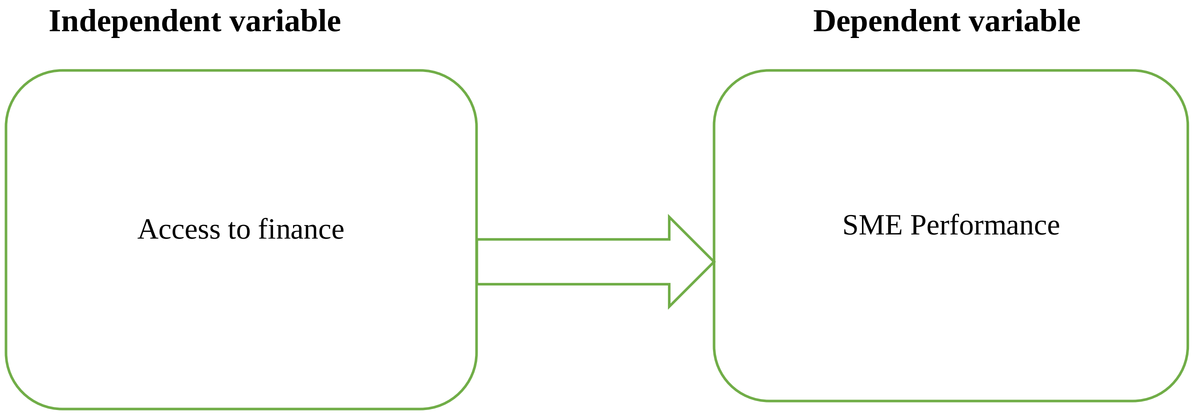
Scott (1981) posits that the optimal strategy for organizing is contingent upon the distinct attributes of the environment in which the organization must operate. Their primary objective is to investigate the impact of contingency variables on organizational structure. The prevalent model of organizational structural theories throughout the 1970s was the structural contingency theory. Pennings performed a significant empirical study in 1970, whereby he examined the correlation between environmental unpredictability, organizational structure, and several performance indicators. The use of this idea has mostly been seen in research endeavors that center on evaluating the performance and efficacy of organizations. Battilana (2012) argues that there is no generally ideal method for arranging a corporation and its structure.

Organizational structures should be designed to align with certain operational factors, such technology or environment, according to contingency theory. Every company encounters unique internal and external challenges, along with specific environmental factors that contribute to varying levels of uncertainty. Consequently, there is no universally ideal organizational design that suits every company. This is because each company possesses its own distinct organizational culture and perspective on risk (Danese, 2013).

In the realm of management and problem-solving, it is apparent that there exists no universally better strategy or approach. In order to properly address and resolve the problem at hand, it is necessary to adopt a distinct strategy for each case. Management and organization are complex processes that often face difficulties and irregularities. In order to successfully tackle the issues at hand, it is necessary to use adaptable and situation-specific solutions (Scot, 1981). A significant amount of criticism was directed on the Contingency hypothesis. Critics contend that this particular paradigm has a deficiency of adaptability, hence rendering it inflexible in essence.

The Contingency theory is highly relevant to this study. According to the theory, organizational success depends on aligning strategies with the specific environmental conditions. When analysing SMEs, the research will investigate on how the connections between socio economic factors and SMEs performance are displayed in this specific geographic and socioeconomic setting. Recognizing the ever-changing context and the dependent nature of these factors, the study aims to explore how SMEs adjust their approaches and activities to address the unique circumstances in the local community, ultimately enhancing our comprehension of how different factors impact SME performance in Lodwar municipality.

Conceptual Framework



Empirical Review

Access to Finance and SME Performance

Access to finance is consistently identified as a paramount factor influencing SME performance globally. SMEs often face significant hurdles in securing adequate funding for operations, expansion, and innovation (Abor & Quartey, 2010; Beck & Maksimovic, 2008). In many developing economies, the challenge is exacerbated by stringent eligibility criteria, high collateral requirements, and a lack of innovative financial products tailored to small businesses (Harash et al., 2014; Omondi & Jagongo, 2018). The African Development Bank (2013) notes the growing demand for retail banking services in Africa, yet the gap in financing remains substantial, particularly for SMEs.

For Kenya, studies affirm these challenges. Shikumo and Mwangi (2020) highlighted determinants of lending to SMEs by commercial banks, often pointing to perceived risk and lack of credit history as deterrents. Mbuva and Wachira (2019) specifically found a strong correlation between access to finance and financial performance of processing SMEs in Kitui County, Kenya, noting banks' reluctance to provide long-term investments. This mirrors broader issues identified by the Global Partnership for Financial Inclusion (2011) regarding SME finance policy. In the unique context of Lodwar Municipality, these challenges are likely amplified by the region's remoteness, limited presence of formal financial institutions, and the predominant reliance on informal economic activities. While digital payments are igniting hope for SMEs in Kenya (Standard Media, 2022), their full adoption and impact in remote areas like Lodwar may still face infrastructural and literacy barriers. The current study aims to specifically quantify this relationship within this underserved region, addressing the lack of localized empirical evidence.

Kassekende & Opondo (2018) argued that the provision of financial services, including credit, deposit, payments, and risk management services, is a fundamental aspect of access to capital for firms. The measurement of access to finance encompasses a range of metrics, including but not limited to access to savings, credit, and financial markets. Government intervention, shown by the provision of funds to emerging firms, may also exert influence. Furthermore, the examination of profit levels and the determination of corporate dividends may provide valuable insights on the accessibility of financial resources. Finance is like the blood in human beings to survive. Getting finance is observed the constraint to growth of the SMEs globally. According to Allen, (2018) he puts it clear that in even those countries that are grouped as G7, the SMEs have the issues of getting enough funds to steer their operations in stable manner like bank loans. It is not deniable that SMEs are the one which dominates in many nations but the loan duration given to them is not enough to turn things around and the interest rate is high for them thus they cannot come up with an idea that cannot be easily copied by the competitors (Basil, 2005).

Abuzayed, (2012) pointed out that the issues can be solved only if we take note of SMEs growth model. But it is not only the responsibility of governments to deal with this issue. SMEs have to come up with good and better initiative plans and recommendations that are solely backed up with sound analyses. In addition, SMEs must spend in bettering their internal management systems and execute effective business plans. This includes accounting, financial administration, strategic planning, operational management, and administration of human resources.

The study by Eeden (2021) in South Africa established a significant challenge faced by SMEs was the restricted availability of financial resources. The study revealed several deficiencies, including a dearth of information pertaining to sources of funding, limitations leading to inadequate financing from domestic commercial banks, the absence of performance records mandated by banks, and insufficient frameworks within funding institutions for engaging with SMEs. According to research conducted by Harash, Al-Timimi and Alsaadi, (2014) to check on the effect of financial access on the operational performance of SMEs located in Iraq, it was evident that SMEs have a substantial obstacle in obtaining financial resources. Smaller enterprises have the capacity to provide job prospects; yet, they often encounter obstacles that impede their expansion or result in a dearth of advancement. These challenges are often associated with constraints imposed by institutions and budgetary restraints. This study will focus on the obstacles to financial access for SMEs in Turkana County.

A recent study by Badi and Ishengoma (2021) explored how debt financing affects SME performance in Tanzania, focusing on firms supported by PASS in accessing formal credit. Data were gathered from 115 participants, yielding a 76% response rateThe utilization of debt and the financial results of SMEs were found to be significantly correlated by the study, with a stronger influence observed on ROA compared to GPM and ROE. These findings suggest that leveraging debt can enhance profitability relative to asset utilization. While the research by Badi and Ishengoma (2021) focused on the agricultural sector in Tanzania, the present study shifts its concern to the access to finance challenges facing SMEs in Turkana County.

The several factors that affect the competitive growth of Lesotho's SME sector were recently investigated by Amadasun and Mutezo (2022). Among the emphasized factors are the following: the accessibility of financial data; the support offered by banks and businesses; the structure of banks; and the collateral needs of the financial sector. The research found that getting your hands on some cash is crucial for SMEs in Lesotho to develop competitively. In order for businesses to have access to suitable financing programs, this paper argues that the Lesotho financial market must undergo a thorough set of legislative measures. While this study by Amadasun and Mutezo (2022) focused on the SME sector in Lesotho, this study will focus on the challenges of access to finance for SMEs in Turkana County.

An investigation into the effect of loan availability on the FP of processing SMEs was carried out in Kitui County, targeting 25 firms. The study engaged 75 participants, including CEOs, financial managers, and chief accountants from each SME. The results demonstrated a greater positive link between access to financial resources and improved financial performance. While the study by Mbuva and Wachira (2019) offered valuable insights, it presents a contextual gap by focusing on Kitui County. The goal of the current study is to close this gap by examining similar issues within the Turkana County SME environment.

METHODOLOGY

The research adopted a descriptive design, which served as the overarching framework for guiding the study towards addressing the stated hypotheses. The target population for this study comprised of SMEs owners/managers. The target demographic included several types of enterprises, including Cloth shops, Clinics, Restaurants, Butcheries and Retail that are operating within Lodwar municipality. The research got the data from the Turkana County Chambers of Commerce. The study relied on primary data, which was obtained directly from res3pondents. Data collection was conducted through the use of structured questionnaires, specifically tailored to capture information relevant to the study variables from SMEs in Lodwar Municipality. Questionnaires were selected as the preferred tool due to their efficiency in collecting uniform responses from a relatively large sample. This method ensured consistency, enhanced reliability, and helped reduce potential researcher bias. The instrument featured a mix of closed-ended and open-ended questions, allowing for both quantitative analysis and the capture of additional qualitative insights from participants.

RESULTS

Response Rate of the Questionnaire

The results of the response rate were 64% which was adequate for further statistical analysis.

Table 1: Response Rate

Category	Frequency	Percentage
Actual Response	90	64
Non-Response	51	36
Total	**141**	**100%**

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The findings also revealed that most respondents strongly emphasized the critical role financial access plays in supporting SME success. Respondents widely agreed that the source of capital, availability of accessible loans, and the ability to meet financing requirements are crucial factors for business growth. Notably, many cited challenges in securing credit due to restrictive loan eligibility conditions, while also affirming that improved financial accessibility would enhance SME productivity and operational efficiency.

Regression Analysis

Coefficient of Determination

This method was used to determine the relationship between access to finance and performance of SMEs

Table 2: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error
1	.788	0.831	0.689	0.36130

a) Predictors: (constant), Access to Finance

b) Dependent Variable: Performance of SMEs in Lodwar Municipality

The findings revealed that access to financing and SME performance is strongly positively correlated, as shown by the R value of 0.788. According to the R Square (0.831), access to financing could accounts for 83.1% of the variance in SMEs' performance. This is a sizable amount and further reinforced the fact that financial access is a key factor in explaining company results in the Lodwar Municipality suggesting that while financial accessibility plays a significant role. These findings align with prior empirical studies, such as Amadasun & Mutezo (2022), who observed that access to credit significantly impacts SME competitiveness and sustainability, particularly in Lesotho.

Analysis of Variance (ANOVA)

Table 2: Analysis of Variance

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	36.121	2	8.321	34.744	.000
	Residual	12.654	65	0.311		
	Total	**48.775**	**67**			

a) Predictors: (constant), Access to Finance

b) Dependent Variable: Performance of SMEs in Lodwar Municipality

The analysis of variance (ANOVA) was used to investigate the impact of financing accessibility on the performance of SMEs in Lodwar Municipality. The p-value of 0.000, which is much below the traditional cutoff of 0.05, indicated that the model was significant for making predictions. This result demonstrated that access to financing significantly explains variation in SME performance and that the regression model used was statistically significant.

Table 3: Regression Coefficients

Coefficients					
Model	**Unstandardized Coefficients**		**Standardized Coefficients**	**T**	**Sig.**
	B	**Std. Error**	**Beta**		
(Constant)	0.322	0.320		1.342	0.176
Access to Finance	0.265	0.080	0.235	3.086	.002

a) Predictors: (constant), Access to Finance

b) Dependent Variable: Performance of SMEs in Lodwar Municipality

The findings indicated that access to finance was statistically significant. Access to finance and SME performance was statistically significant suggesting that SMEs perform better when they have more access to financing. More precisely, assuming all other variables stay the same, a one-unit increase in access to financing is linked to a 0.265-unit rise in SME performance.

CONCLUSION AND RECOMMENDATIONS

Conclusion

The findings indicate a strong positive correlation between access to financing and the performance of small and medium-sized enterprises (SMEs). This implies that as SMEs gain better access to financial resources, their overall performance improves significantly. Financial access allows SMEs to invest in modern equipment, hire skilled labor, expand production, improve product quality and explore new markets. Without adequate financing, SMEs may struggle with cash flow issues, limited operational capacity, and restricted growth, which ultimately hampers their ability to compete and thrive in the marketplace. From this relationship, it can be concluded that enhancing financial access for SMEs is essential for their sustainability and growth. Moreover, this means that firms or individuals with better access to financial resources (like credit, loans, or investment capital) are more likely to experience improved outcomes—such as higher profits, growth, efficiency, or market competitiveness.

Recommendations

Policymakers, financial institutions, and development partners should therefore prioritize interventions that lower borrowing barriers, provide affordable credit and strengthen financial literacy among entrepreneurs. By addressing the financing gap, such efforts would not only boost the productivity and profitability of SMEs but also contribute to broader economic development through increased employment, innovation, and income generation.

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