

E-ISSN: 2469-4339

Management and Economics Research Journal, Vol. 5, Iss./Yr. 2019, Pgs. 7

Original Research Article

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HATASO, USA

Examining the Contribution of Interest Rate Capping Conditions on Financial Performance of Women-Owned Agribusiness SMEs in Nyeri Central Sub County, Kenya

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Received: Sep 19, 2019; Accepted: Nov 08, 2019

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Citation: Kiai RM, Kiambati K. 2019. Examining the contribution of interest rate capping conditions on financial performance of women-owned agribusiness SMEs in Nyeri Central Sub County, Kenya. Management and Economics Research Journal, Vol. 5, Article ID 953268, 7 Pages. <https://doi.org/10.18639/MERJ.2019.953268>

Abstract

Financial inclusion has remained a critical driver toward poverty reduction in an economy. There has also been much focus on financial inclusion of women as they tend to be marginalized by the mainstream financial institutions. Kenya on its part has achieved high levels of financial inclusion. Access to bank services has been easy and at a low cost. Till 2016, access to credit has also been easy for all persons with bankable ideas in all sectors including agriculture for either gender. However, this changed after the review of the Banking Act that introduced the interest rate capping in the financial market. The purpose focused on increased collateral requirement and additional customer information requirements on the financial performance of women-owned Agribusiness small and medium enterprises (SMEs). The target population of this study was 950 licensed women SMEs with a sample of 274 licensed SMEs. From the study, collateral requirement due to interest rate capping had a negative and statistically insignificant effect ($r = -0.114$, $p = 0.079$) on the financial performance. On a positive note, the study found that additional customer information requirement due to interest rate capping had a positive and statistically significant contribution ($r = 0.437$, $p = 0.000$) on financial performance of agribusiness SMEs. The study concluded that effective maintenance of financial records not only helps SMEs access credit but also help them improve performance. This study strongly recommends capacity building among women on maintenance of financial records as it will improve access to credit and performance of their businesses.

Keywords: Capacity building; Credit; Collateral; Customer information.

1. INTRODUCTION

1.1. Background

Agriculture is the livelihood of majority of Kenyans providing income to more than 80% of population and employing an average of 40% of the population. Agriculture SMEs are often seen as unattractive clients to most financial institutions, this is due to their small asset base and their seasonal nature. The economic survey of 2017 established that there were about 1.56 million licensed SMEs and 5.85 million unlicensed businesses. The importance of small- and medium-sized enterprises in Kenya was reflected in the Economic Survey in 2014, which signified that 80% of the 800,000 jobs created in 2014 were in the informal sector, which is dominated by small- and medium-sized enterprises (Kandie, 2014; Irungu, 2017). The SME sector has been segmented in the following manner in Kenya, 40% are in the trade industry, 30% in the agriculture industry, 13% in the manufacturing industry, 15% in the service industry, and about 2% in the construction industry (Musando, 2013).

Access to credit is a critical success factor in any economy as it gives a chance to those who do not have finances to access finance and actualize their entrepreneurial ideas. According to Levy (2015), the challenge to finances hinders growth as well as development of these institutions. Access to credit in Kenya has been seamless for even SMEs until the introduction of interest rate capping in 2016 through the review of the Banking Act. Interest rate capping is a restriction on the rate at which commercial banks lend loans to its customers. This affected the business people with no regular source of income and particularly women-owned agribusiness SMEs (Mbua, 2017; Mwaniki, 2017). This puts into stake the success of women business in Kenya. It also has a negative effect on one of the “Big Four” agenda of the government of Kenya on food security, and Sustainable Development Goals on ending hunger, achieving food security and improved nutrition, and promoting sustainable agriculture.

Globally, 76 nations are currently utilizing some form of interest rate caps on loans (Maimbo and Gallegos, 2014). Interest rate caps are utilized by governments for various economic as well as political reasons; the most common reasons are to offer support to a precise area of the economy or an industry. An economy might identify a market failure within a certain industry, or that the interest rate cap may be intended to greatly focus on certain financial institution in a particular market. Another reason may be to discourage financial institutions in making extreme profits by charging excessive rates of interest to customers. In such a case governments intervene to protect vulnerable clients from predatory lending practices (Miller, 2013). However, interest rate capping might have a negative effect on the economy. For instance, in Ecuador, introduction of capping on lending lead to commercial banks increase the average amounts of loans so as to survive. Small banks were left with no choice but were bought by larger banks. Caps also led to illegal lending flourishing in the country (Olaka, 2017). Interest rate caps introduction in Japan also lead to reduced loan applications, and illegal lending rose (Porteous *et al.*, 2010). In January 2013, Zambia introduced the interest rate capping that led to the near collapse of the credit market for households and SMEs. Zambia’s local currency was hard hit as lenders gave hard currency loans to the non-tradable sectors that affected the economy of the country adversely, the caps were dropped in 2015 (Olaka, 2017). The interest rate capping in Zambia lend to constrained credit lending to SMEs (Miller, 2013).

In Kenya, the law on interest rate capping came into effect in September 2016. The interest rate was capped at 4% of the Central Bank Rate (CBR). Lending to SMEs has declined in value since the implementation of the interest rate capping; this has been reflected in commercial banks, loan approvals declined by 6% between December 2016 and February 2017 as per the CBK Newsletter for 27th March 2017. The reduced SMEs sector credit would bring about economic growth that is constrained, which means that the state would not be capable of attaining the 6% rate of growth anticipated in the future. The latest data indicate that bank lending to small- and medium-sized enterprises has declined by 5.7% between August 2016 and April 2017, the reason being that SMEs are considered among the riskiest category of borrowers by commercial banks because of their high level of failure after startups (Mbua, 2017; Mwaniki, 2017). The purpose of this study was to find out the contribution of increased collateral requirement and customer information requirement after the introduction of interest rate capping.

1.2. Statement of the Problem

The introduction of the interest rate capping on lending made financial institutions increase their lending conditions to their customers. Some of the agribusiness SMEs, especially women-owned, are not able to meet the required conditions. This has led to constrained access to finances causing a decline of 5.7% of loans (Mwaniki, 2017). This study was performed to find out the contribution of increased conditions on financial performance of women-owned SMEs in agribusiness, Nyeri Central Sub County, Kenya.

1.3. Objectives of the Study

1. To examine the influence of increased collateral requirement on the financial performance of women-owned agribusiness SMEs in the Nyeri Central Sub County.
2. To assess the influence of customer information requirements on the financial performance of women-owned agribusiness SMEs in the Nyeri Central Sub County.

2. METHOD(S)

This research adopted the quantitative research approach and causal design using quantitative analysis. The target population was licensed women SMEs in the agribusiness sector in the Nyeri Central Sub County. Given that Nyeri is an agricultural economy town the study focused on agribusiness activities. The research followed stratified sampling design to select a sample that represented the entire population of the study. This research employed a stratified sampling technique dividing the population into agro vets, poultry farmers, cattle farmers, food crop farmers, and horticulture. A sample of 274 women-owned SMEs was determined based on the Krejcie and Morgan's criterion. The response rate was 86.5%, which was considered adequate. The study used questionnaires as the primary data collection tool. The data collection process was subjected to a pilot test and Cronbach's alpha (α) coefficients results were greater than 0.7, which indicated that the instrument of research was reliable.

3. RESULTS AND DISCUSSION

3.1. Test of Regression Assumption

Before running a model of regression, tests of pre- as well as post-estimation were carried out. A test for multicollinearity was performed, wherein tolerance was recorded to be more than 0.20 and Variance Inflation Variable to be less than 5, indicating that there was no multicollinearity. A linearity test was conducted by using Pearson's Product-Moment Coefficient Correlation (r). The findings of the correlation analysis showed that Collateral requirements had negative and insignificant contribution toward SMEs financial performance with $r = -0.114$; $p = 0.079 > 0.05$ at 0.05 significance level. Customer information requirements had positive and significant contribution toward SMEs financial performance with $r = 0.437$; $p = 0.000 < 0.05$ at 0.05 significance level.

3.2. Collateral Requirements and Financial Performance

3.2.1. Descriptive Analysis for Collateral Requirements

The first objective one of the studies sought to explore was the influence of increased collateral requirement has on the financial performance of women-owned agribusiness SMEs in the Nyeri Central Sub County. Descriptive statistics were performed to determine the contribution of increase of collateral requirement due to the interest rate capping on financial performance of agribusiness SMEs. The results indicated that introduction of the interest rate capping affected collateral value required by financial institutions with a high extent. In a Likert of 1–5, the mean score was 3.62 and standard deviation 0.916. Lack of fixed assets/collateral being a hindrance to access to credit from financial institutions had a mean score of 2.56 and a standard deviation of 1.102. The study further revealed that most respondents indicated that the availability of adequate collateral mitigates the agribusiness SMEs risk factor with a mean score of 3.60 and a standard deviation of 1.031. The finding of the study supports Bougheas (2005), who noted that collateral is an important prerequisite to access finance from financial institutions. Etemesi (2017) stated that collateral reduces the risk factor of a loan by giving the financial institution a claim on the tangible asset. A research on the challenges that SMEs face in accessing finance from financial institutions revealed that not many SMEs are successful in accessing funding from financial institutions, this is because they fail to meet lending requirements, which include collateral security (Gangata and Matavire, 2013; Makena *et al.*, 2017).

3.2.2. Relationship between Collateral Requirements and Financial Performance of SMEs

To find out the relationship between collateral requirement and financial performance of women-owned agribusiness SMEs, a bivariate linear regression analysis was performed. The results of bivariate linear regression analysis are shown in Tables 1 and 2.

The R value of 0.114 indicated that there was a weak linear relationship between the variable collateral requirement and financial performance. The value of R^2 showed the independent variables explanatory power of 0.013. This means that collateral requirement explains 1.3% of the changes in SMEs financial

Table 1. Model Summary for Collateral Requirements.

Model	<i>R</i>	<i>R</i> ²	Adjusted <i>R</i> ²	Standard Error of the Estimate
1	0.114 ^a	0.013	0.009	0.86250

^aPredictors: (Constant), collateral requirement.

Table 2. Coefficients for Collateral Requirements.

Model		Unstandardized Coefficients		Standardized Coefficients		Significance
		B	Standard Error	Beta	<i>t</i>	
1	(Constant)	4.737	0.471		10.059	0.000
	Collateral Requirement	-0.225	0.128	-0.114	-1.766	0.079

^aDependent Variable: SMEs Financial Performance.

performance. With the support of earlier literature, requirements of collateral act as a mechanism of incentive as higher collateral implements a selection of projects that are less risky (Bester, 2007). This is because a low-risk borrower has a bigger incentive to guarantee collateral as compared with a high-risk borrower, hence a lower probability of failure and loss of collateral. This means collateral considered alone has an insignificant contribution. Coefficients for Collateral requirements are as shown in Table 2.

The results of the coefficient of collateral indicated that there was a negative and insignificant linear correlation between collateral requirement and financial performance. This was because the *p* value of 0.079 was above 0.05. This signifies that increasing the collateral requirement by one unit would lead to a decrease in SMEs financial performance by 0.225.

According to Gitman (2003), collateral pledging is defined as the degree to which borrowers commit assets to a lender as security for payment of debt. Kihimbo (2012) noted that collateral requirements reduce inappropriate use of the funds by SMEs. From the study, it is obvious that the majority of SMEs are discriminated as well as denied by the lenders in offering financing; this is owing to the high risk associated with them lacking adequate resources to pledge as collateral. A case of Belaway, Zimbabwe revealed that SMEs are unsuccessful in securing loans owing to financial institutions' restrictive requirements, top among them being lack of collateral, these requirements have been tightened with the introduction of interest rate capping, due to the small profit margin the financial institutions enjoy on interest rate ceilings.

3.3. Customer Information Requirements and Financial

3.3.1. Performance Descriptive Analysis for Customer Information Requirements

The second objective of the study sought to assess was the influence that the customer information requirements has on the financial performance of agribusiness SMEs in the Nyeri Central Sub County. Descriptive statistics were performed to determine the contribution of customer information requirements due to the interest rate capping on financial performance of agribusiness SMEs. The results of the descriptive statistics indicated that most of the respondents indicated that some of agribusiness SMEs are not enlightened in keeping proper books of accounts and therefore are not able to give credible financial information to the financial lenders with a mean score of 3.56 and a standard deviation of 0.755. The respondents also indicated that when the information required is not reliable, the cost of lending to the SMEs increases and the

credit worthiness of the agribusiness SMEs reduces with a mean score of 3.08 and a standard deviation of 0.993. Poor management and skill by small and micro SMEs is an obstacle to the accessibility of finances by the SMEs, as they are not able to meet the lender requirements that had a mean score of 2.59 and a standard deviation of 1.196.

According to Berger (2006), the access to credit information in environments of local lending determines the degree to which small enterprises get adequate external financing for the exploitation of projects that are profitable. The degree to which the environment of business hinders the optimal credit provision determines the funding size gap that the agribusiness SMEs might face. Berger noted that one challenge that faced agribusiness SMEs when attempting to access credit is information asymmetry; this is because they are not able to prove the value and quality of their investment projects to the financial institutions. He further noted that some of agribusiness SMEs are not enlightened in keeping proper books of accounts and therefore are not able to give credible financial information to the financial lenders.

Tucker and Lean (2003) stated that financial institutions actually depend on past financial performance as an indicator for the future projects profitability. However, SMEs tend to be restrictive when it comes to giving detailed core information about their businesses to external financiers that limit them from accessing credit.

3.3.2. Relationship between Customer Information Requirements and Financial Performance of SMEs

The results of multiple linear regression analysis are shown in Tables 3 and 4.

The value of *R* of 0.437 indicated that there was a linear correlation between the variable customer information requirements and financial performance. The value of *R*² signified the independent variables explanatory power of 0.191. This signifies that customer information requirements explain 19.1% of the changes in SMEs financial performance. Tucker and Lean (2003) stated that financial institutions actually depend on past financial performance as an indicator for the future projects profitability; this literature supports the researchers’ findings of how customer information requirements is significant to the SMEs.

The coefficient results indicated that there was a positive and significant linear relationship between customer information requirements and financial performance of SMEs. This was because the *p* value of 0.000 was below 0.05. This signifies that increasing the customer information requirements by one unit would lead to an increase in SMEs financial performance by 0.378 as indicated in Table 4. The equation of bivariate linear regression model fitted by the use of unstandardized coefficients is: $Y = 2.532 + 0.378CIR + \epsilon$.

Table 3. Model Summary for Customer Information Requirements.

Model	<i>R</i>	<i>R</i> ²	Adjusted <i>R</i> ²	Standard Error of the Estimate
1	0.437 ^a	0.191	0.188	0.78076

^aPredictors: (Constant), Customer Information Requirements.

Table 4. Coefficients for Customer Information Requirements.

Model		Unstandardized Coefficients		Standardized Coefficients		Significance
		B	Standard Error	Beta	<i>t</i>	
1	(Constant)	2.532	0.192		13.192	0.000
	Customer information requirements	0.378	0.051	0.437	7.456	0.000

^aDependent Variable: SMEs Financial Performance

Vuvor and Ackah (2011) explained that most SMEs are faced with chief challenges in accessing credit because they were unable to give collateral as well as other information required by financial institutions for instance financial statement, which are audited coupled with the high loan cost in terms of high interest rates making it very difficult to access loans from banks. Ono (2005) stated that SMEs in Africa sometimes meet the requirements set by financial institutions, though it is quite a challenge for them to provide the required financial information to the financiers.

4. CONCLUSION

From this study, it is concluded that the increase of collateral requirement due to interest rate capping had a negative and statistically insignificant contribution on financial performance of agribusiness SMEs. This could be associated with the fact that collateral alone could not be the main consideration to determine how much an agribusiness trader can access from financial institution though it is a consideration as security. It is recommended that borrowers emphasis more on other requirements that are supposed to be fulfilled while requesting for a loan.

The key finding and conclusion from the study is the fact that additional customer information requirement due to interest rate capping had actually a positive and statistically significant contribution toward financial performance of women-owned agribusiness SMEs. It is thus important to enhance the capacity of women on record keeping. Improving the capacity helps them access credit and it also helps them improve on financial performance of their businesses.

Acknowledgment

No financial or material support.

Authors' Contributions

The two authors contributed equally in the research and in authoring this article.

Conflict of Interest

None.

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