

Influence of Information Availability on the Choice of Source of Entrepreneurial Finance

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Abstract

This study examines the influence of information availability on the choice of source of entrepreneurial finance for small and medium sized enterprises in Thika district of Kenya. This study adopted a mixed methods empirical survey design. The population of interest was composed of all SMEs in Thika District. Stratified random sampling method was used and 259 SMEs were selected out of the target population of 800 small- and medium-sized enterprises. The questionnaire was addressed to the owners or finance managers. Analysis of the data was done using descriptive and inferential statistics. The study rejected the null hypothesis, H_0 since choice of source of financing showed a statistically significant association with information availability, in form of newspapers and magazines, shows and exhibitions and personal contacts. The study found it necessary that entrepreneurs should adopt medium of communication that would lower the perceived risk in financial transactions especially that perceived in assuming debt capital. Mainly, the forms of communication were: personal selling, shows and exhibitions, where a certain level of interaction between borrower and lender is possible.

Key Words: Information availability, choice of source of entrepreneurial finance, small and medium sized enterprises in Thika District.

Introduction

Influence of information availability on choice of Entrepreneurial finance

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, 1984). 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 (Fama and French, 2005). 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.

Migiro (2006) 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 (Migiro, 2006).

Policies and strategies designed to boost credit and finance to the MSE sector have been formulated in the absence of reliable information on appropriate methodologies, data on the magnitude of the sector, characteristics of the sector operators and factors influencing the growth and dynamics of the sector (Green, Kimuyu. and Murinde, 2002). The situation translates into high credit transaction costs for collecting and verifying available information mainly on the creditworthiness of sector borrowers.

Namusonge (2004) conducted a study whose intention was to investigate how three selected development financial institutions (DFIs) in Kenya have helped or hindered the acquisition of technological capabilities in SMEs. The rationale for selecting these institutions was that DFIs have important but underutilized capabilities for providing credit and consultancy services for technological development.

In dealing with entrepreneurial firms, providers of capital try to circumvent the problem of asymmetric information in a variety of ways. Venture capitalists often place one of their own people on the management team or Board of Directors for firms that they fund (Kothari, 1993). They also establish specific performance benchmarks and dole out successive rounds of financing only when designated targets have been achieved. Again, establishing on-going banking relationships is another way to deal with the problem of asymmetric information. In a study of small firms, Petersen and Rajan (1994) found that firms that concentrated their borrowing among a smaller number of banks benefited from lower interest rates and greater availability of financing.

Similarly, Berger and Udell (1998) found that longer banking relationships led to lower interest rates on loans. Further, banks were less likely to require collateral from firms with whom they had longer term relationships. These relationships provide lenders with the opportunity to learn about privately held firms and to gain a better understanding of their prospects for growth and profitability.

The study identified local company support, private sector support, funds from levies contributions by research beneficiaries, contract mechanisms, foreign direct investment (FDI), joint ventures, licensing franchising, management contracts, marketing contracts, turnkey contracts, technical service contracts and international sub-contracting as alternative sources of project financing.

The study concluded that DFIs and Government should increase funding for SME financing cycles covering idea generation, feasibility study, project design and project implementation. These programs were proposed in order to increase the success rate of SMEs that are funded.

In view of the above review the following hypotheses was tested:

H₀: Information availability does not influence the choice of source of entrepreneurial finance

Methodology

The study adopted a descriptive and empirical survey research design. The population of interest was composed of all SMEs in Thika District registered in the Thika Business Directory. The sample comprised 259 SMEs drawn from the service sector, the trading sector and the manufacturing sector. The sample was selected using stratified random sampling techniques. Data was collected by administering questionnaires on the entrepreneurs.

The formulated hypothesis was tested using the chi-squared test and logistic regression at 5% level of significance.

Results and Discussion

The Effect of Information Availability on Choice of Source of Entrepreneurial Finance

Table 1: Selected Sources as Information Sources

Sources of Information Availability	No	Yes
Personal enquiries	60.20%	39.80%
Local FI, exhibitions & shows	60.90%	39.10%
Radio stations	86.40%	13.60%
Newspapers/ magazines & journals	90.80%	9.20%

The majority of the respondents did not view local radio stations as a source of information on potential sources of entrepreneurial finance. An equally large percentage of the respondents unanimously opined that newspapers and magazines were not a source of information.

Most of the respondents (60.90%) did not view local exhibitions and shows as sources of information. A significant smaller number (39.10%) did not share this opinion. A majority (60.20%) did not consult friends and colleagues for information on potential sources of entrepreneurial finance. A significant number however, did consult from those around them.

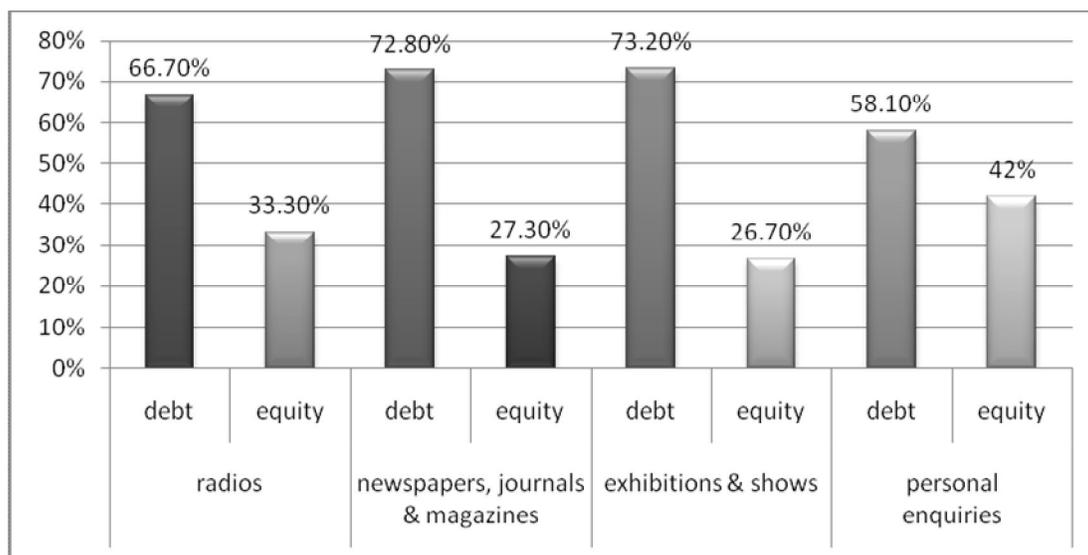


Figure 1: Sources led to by the Various Information Sources

Local radio as a source of information resulted in the entrepreneurs choosing more debt (commercial banks) than equity in the form of SACCOs and personal savings. Print media mainly led entrepreneurs to sources of debt predominantly banks. Local shows and exhibitions mainly led to a majority of debt sources (bank borrowings) and a minority of equity sources such as SACCOs. Personal contacts led entrepreneurs to not so dissimilar proportions of debt in form of bank borrowings and equity in form of SACCOs and savings.

Personal enquiries were by far the source of information that led entrepreneurs to the highest source of equity financing compared to the others. The mass media forms of advertising such as electronic and print media are normally paid forms of advertising accessible to lenders and will naturally be the channels through which lenders will reach borrowers. Personal contacts, on the other hand, will lead to equity as well as debt sources depending on what is sought.

Table 2: Influence of Information on Sources on Choice of Source of Finances

	No extent	small extent	moderate extent	great extent	greatest extent
Radio stations	30.90%	5.50%	14.50%	30.90%	18.20%
Print media	14.60%	4.20%	22.90%	43.80%	14.60%
Shows/exhibitions	12.70%	12.70%	18.60%	43.10%	12.70%
Personal contacts	8.50%	10.60%	20.20%	47.90%	12.80%

Among those who responded, the situation was tied between those who rated radio as not influencing choice of source of finance at all, and those who rated radio as influencing finance to a great extent. Majority of the respondents rated the print media as influencing choice of source of finance to a great extent followed by those who rated these media to a moderate extent.

Exhibitions and shows largely influenced choice of source of entrepreneurial finance to a great extent. Personal contacts mostly influenced choice of source of entrepreneurial finance to a great extent with a significant number also influencing issues to a moderate extent.

Table 3: Mean Values of Information Sources on Choice of Source of Finance

Information Sources	Mean	Std. Dev.
Local radio stations effect	3.00	1.540
Local FI, exhibitions & shows	3.30	1.225
Newspapers/magazines and journals	3.40	1.233
Personal enquiries	3.41	1.168
Valid N (list wise)		

The overall mean values indicate the personal contacts most influenced search for entrepreneurial finance (at a moderate extent) with the highest mean value among the four options under investigation.

Table 4: Reasons for Choosing Current Avenues of Entrepreneurial Finance

	No	Yes
Needed finances	44.50%	55.50%
Personal contacts	45.90%	54.10%
Shows & exhibitions	64.40%	35.60%
Radio stations	77.40%	22.60%
Print media	86.30%	13.70%

A majority of respondents chose to acquire finances since the business needed finances and they had information on where to obtain these finances. Personal contacts were the second most influential sources of information on funding availability, followed by local financial institutions, shows and exhibitions, local radio stations and, lastly, newspapers, magazines and journals. Persons who cited personal contacts as influencers were roughly equal in proportions to those that did not see these as reasons for choosing current funding sources.

Table 5: Extent of Influence on Information Availability on Entrepreneurial Finance

Influence on Information Availability	Frequency	Percentage (%)
No Extent	73	32.4
Small Extent	9	4.1
Moderate Extent	30	13.7
Great Extent	95	42.9
Greatest Extent	16	6.8
Total	223	100

In summary, majority of the respondents were of the opinion that information availability did not influence them to go for entrepreneurial finance. A significant number rated this influence at a small extent. The distribution had an overall mean of 2.88 and a standard deviation of 1.427 (n=219; N=236). Thus, it can be concluded that overall information availability influenced sources of entrepreneurial finance to a moderate extent.

A significant number of entrepreneurs felt that information availability had the effect of improving access to finance. An equally important segment did not think that information availability was of any influence in terms of facilitating entrepreneurial financing. The mean of the distribution was 1.50 and standard deviation of 0.765, implying that the overall perception was that information availability had no effect on choice of source of entrepreneurial finance.

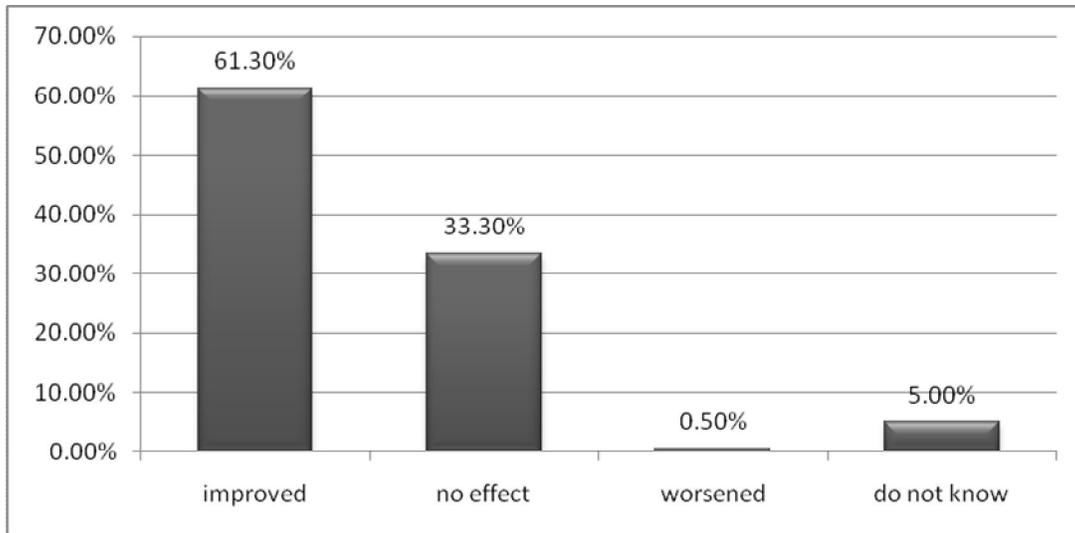


Figure 2: Effect of Information Availability on Choice of source of Entrepreneurial Finance

Test of Hypothesis

H₀₂: Availability of information does not affect choice of source of entrepreneurial finance

Table 6: Chi Square Test of information availability versus Source of Finance (Yr 1)

	Pearson Chi-Square (χ^2) value	df	Asymp. Sig. (2-sided)
Print Media versus Source (Summary)	1.147(a)	2	0.564
Shows & Exhibitions versus Source (Year 1)	6.919 ^a	2	0.031
Shows & Exhibitions versus Source (Year 2)	7.214 ^a	2	0.027
Shows & Exhibitions versus Source (Year 3)	11.208 ^a	2	0.004
Shows & Exhibitions versus Source (Summary)	6.347^a	2	0.042
Personal Contacts versus Source (Year 2)	11.616 ^a	2	0.003
Personal Contacts versus Source (Summary)	4.802^a	2	0.091

Choice of sources of finance demonstrates a statistically significant relationship with shows and exhibitions in year 1 ($\chi^2=6.919$, $df=2$, $p=0.031$), year 2 ($\chi^2=7.214$, $df=2$, $p=0.027$) and year 3 ($\chi^2=11.208$, $df=2$, $p=0.004$). The overall relationship between choice of sources of financing and shows and exhibitions was statistically significant ($\chi^2=6.347$, $df=2$, $p=0.042$). The conclusion is that shows and exhibitions due influence source chosen through providing objectively verifiable information and helping overcome investor fears and bias relating to these different sources of financing.

Choice of sources of financing had a statistically significant relationship with personal contacts over year 2 ($\chi^2=11.616$, $df=2$, $p=0.003$). The overall relationship for the three years was not statistically significant. These contacts may have been important in year 2 since the entrepreneurs felt that, as their businesses grew, they needed to obtain information on additional sources of financing.

Conclusion

In terms of choice of source of finance, the implication posed by the null hypothesis is that the distributions data relating to choice of source of entrepreneurial finance are the same for all SMEs regardless of their ability to obtain market information with regard to sources of financing. Among the sources of information selected, the print media chosen showed a statistically significant relationship in year 1, meaning that newspapers and magazines influenced the choice of source of financing in year 1.

On the other hand, shows and exhibitions demonstrated a significant relationship for the entire period under consideration. Personal contacts demonstrated a statistically significant relationship only in year 2. In the logit regression model, when the proxies for information availability were examined stepwise, none showed a predictive ability in relation to the proportion of equity deployed in the financing mix.

Given the significant associations revealed by shows and exhibitions and personal contacts, the study rejected the null hypothesis H_0 . Consequently, the study accepted the alternative hypothesis, H_1 , that availability of information affects choice of source of entrepreneurial finance.

Recommendation

Entrepreneurs also suggested the need to consult more with financial institutions such as banks and SACCOs, save more and keep themselves updated on current business affairs through reading newspapers and business magazines. Finally, entrepreneurs recognized the need for healthy competition as an incentive to improve marketing of goods and services as well as reducing the cost of doing business such as lower operating costs, sourcing for lower interest rates and reduced licensing requirements.

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