

FACTORS AFFECTING FINANCIAL INCLUSION AMONG SMALL AND MEDIUM ENTERPRISES OWNERS IN NAIROBI COUNTY, KENYA

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Abstract

The study sought to identify factors affecting financial inclusion among owners of small and medium-sized enterprises in Nairobi County, Kenya. The specific objectives were to: determine the effect of financial literacy, demographic characteristics, and information asymmetry on financial inclusion among small and medium enterprises owners in Nairobi County, Kenya. The analysis adopted a descriptive research design and targeted all of Nairobi County's registered SMEs which were 312,981. The respondents included owners of the SMEs. The sample was 384 owners who were selected using stratified random sampling. The study used primary data that was collected using structured questionnaires. Findings indicated that financial literacy has a positive and significant effect on financial inclusion among SMEs owners ($\beta = .353$, $P = .000$), demographic characteristics have a positive and significant effect on financial inclusion among SMEs owners ($\beta = .628$, $P = .000$), information asymmetry has a negative and significant effect on financial inclusion among SMEs owners ($\beta = -.488$, $P = .000$) and combined, financial literacy, demographic characteristics, and information asymmetry were significant (adjusted $R^2 = 0.678$; $F = 202.750$; $P = 0.000 < 0.05$). The study concluded that demographic characteristics have the greatest effect on financial inclusion, followed by financial literacy and lastly information asymmetry. Based on the findings, the study recommended that SMEs owners should seek financial knowledge; the government should pass a statute that requires financial institutions to publish information regularly; and should ensure that all SMEs are financially included to enable them access credit easily and make sound financial decisions.

Keywords: Demographic characteristics, Financial Inclusion, Financial Institutions, Financial Literacy, Information Asymmetry, Small and Medium Enterprises

Introduction

Financial inclusion is a key component of any country's all-inclusive social, political, and economic development. Advancing balanced economic growth and financial inclusion is vital to sustainable development as it encompasses majority of the population in developing countries, such as the poor and the vulnerable (Agyemang-Badu, Agyei, & Duah, 2018) communities in both urban and rural populations (Were & Wambua, 2013). Financial inclusion allows for a country's enhanced and more sustainable economic and social development (Were & Wambua, 2013). This also recognizes the participation of disadvantaged groups, such as poorer portions of the population and low-income families, depending on their degree of access to financial resources such as savings and loan plans, credit protection, and pensions (Kathuo, Rotich, & Anyango, 2015). Besides, the goal of financial inclusion is the simple availability of financial resources that require maximum investment in business opportunities, schooling, retirement savings, rural citizens, and businesses to insure against risks (Rebei, 2014).

The Kenyan government is on a plan aimed at ensuring quality financial services, particularly for the society's lowest carders. Findings from the FinAccess (2019) household survey indicated that financial inclusion environment in Kenya has undergone a transition since 2006. Formal

financial inclusion has grown to 82.9% from 26.7% in 2006, while overall exclusion has shrunk from 41.3% in 2006 to 11.0%. Furthermore, the gaps in financial exposure between the wealthy and the poor, men and women, and rural and urban areas have substantially deteriorated. Key drivers of those changes included; mobile money growth, government initiatives, and funding, and information and communications technology innovations.

FinAccess (2019) survey recorded a significant reduction in the proportion of adults excluded from financial services and products that support government policies, initiatives, and reforms, as well as the widespread adoption by financial sector players of digital technology and innovations. These have helped to deepen financial inclusion by enabling people to overcome infrastructural constraints, particularly in rural areas. As much as progress has been made, problems of affordability and consumer protection such as unexplained charges remain obstacles to structured access to the service. The remarkable modesty of the developmental impact of structured financial access is even more noteworthy.

Access is the willingness of formal institutions to use available financial resources and products, or it is the ability to deliver financial services and products to financial institutions (Kavwele et al., 2018). Examining access means recognizing possible obstacles that companies face in providing their services and goods, or that customers encounter in using them. Access metrics display the level of coverage of financial services, such as penetration of the bank branch or point of sale (POS) apps in rural areas (information accessible from supply-side data) or demand-side obstacles that consumers encounter when accessing financial institutions, such as costs or details (Gichana et al., 2014); Access has many dimensions: services must be available when needed, and goods must be customized to specific needs; rates for these services must be affordable, including all non-price expenses, such as having to travel a long distance to a branch of the bank.

Small and Medium Enterprises (SMEs) is a business unit with a limited number of workers not exceeding 100 and its sales volume is less than 4 million per annum (Karlan & Zinman, 2007). SMEs are commonly privately owned and operated sole proprietorships, corporations, or partnerships. Financial constraints are generally higher but SMEs are particularly constrained by financial system gaps such as high operating costs, high collateral requirements and lack of financial intermediary experience (Gichana, Mukulu, & Odhiambo, 2014; Kavwele et al., 2018). Increased access to finance for SMEs in developing countries may improve economic conditions (Mia, 2017).

One of the main problems facing emerging markets is to shift informal SMEs from the informal sector to the formal sector, allowing them to increase access to financial credit and other government support services. The vast number of SMEs needs greater access to finance in both the formal and informal sectors (Rambo, 2013). Improving access to financing for SMEs, thus, will not only improve their capacity to create and prosper, but will also increase policy production and growth, in addition to reducing unemployment (Niskanen, 2010). In all countries around the world financial inclusion has gained prominence. Studies have shown that financial inclusion not only helps individuals grow strong economically but also helps the nation grow strong economically. Despite so many attempts over the years, the goal of achieving 100 percent financial inclusion remains unfulfilled. Work on solutions that promote financial inclusion is still needed because around two billion people are financially excluded across the globe (Grandolini,

2015). Worldwide experts have concluded that small and medium-sized businesses play critical roles. In theory, they accepted that small and medium-sized enterprises (SMEs) play an important role in every country's economic growth. Despite the contribution by SMEs to the economic development globally, several factors seem to affect their performance such as lack of access to credit which has been cited by past studies as the biggest challenge that affects performance and growth (Bunyas et al., 2014). It is against this backdrop that the current study attempted to identify factors affecting financial inclusion among owners of small and medium-sized enterprises in Nairobi County.

Research Objective/Hypothesis

General Objective

The main objective of the study was to determine factors affecting financial inclusion among small and medium enterprises in Nairobi County, Kenya.

Specific Objectives

- i. To determine the effect of financial literacy on financial inclusion among small and medium enterprises owners in Nairobi County, Kenya.
- ii. To determine the effect of demographic characteristics on financial inclusion among small and medium enterprises owners in Nairobi County, Kenya.
- iii. To determine the effect of information asymmetry on financial inclusion among small and medium enterprises owners in Nairobi County, Kenya.

Research Hypotheses

To achieve the objective, the study tested the following hypotheses:

- i. H₀₁: There is no significant relationship between financial literacy and financial inclusion among small and medium enterprises owners in Nairobi County, Kenya.
- ii. H₀₂: There is no significant relationship between demographic characteristics and financial inclusion among small and medium enterprises owners in Nairobi County, Kenya.
- iii. H₀₃: There is no significant relationship between information asymmetry and financial inclusion among small and medium enterprises owners in Nairobi County, Kenya.

Methodology

This study adopted a descriptive research design. The target population for this study was all registered SMEs in Nairobi County which is 312,981. These are SMEs from all categories. The survey respondents were owners of the SMEs, as they were familiar with the research subject matter.

The sample size of 384 SMEs was obtained by use of the Cochran equation as indicated below:

$$n = \frac{z^2 p (1-p)}{e^2}$$

Where;

n = sample size

z = the standard deviation value for the level of confidence, for instance, 95% level of confidence = 1.96

e = margin of error (level of precision set at 5% in the study)

p = since the proportion of the population with the characteristic is not known, then 50% will be used. $P=0.5$

Therefore, the sample size was derived as follows;

$$n = \frac{(1.96^2)(0.5)(1 - 0.5)}{(0.05)^2}$$
$$n = 384$$

A stratified sampling method was employed to ensure that there is no bias in determining sample size. SMEs were divided into seven sectors that formed seven strata. The proportionate sampling method was used to determine the sample per stratum of the 384 owners of SMEs based in Nairobi County. Table 1 presents the sample size distribution.

For example,

$$\begin{aligned} \text{General trade} &= 199600/312981 * 384 \\ &= 245 \end{aligned}$$

Table 1: Sample Size

Sector	population	Sample
General trade, wholesale, and retail	199,600	245
Transport, storage, and communication	13,685	17
Agriculture, forestry, and natural resources	946	1
Accommodation and catering	21,681	27
Professional and technical services	49,125	60
Private education, health, and entertainment	6,999	9
Industrial plants, factories, and workshops	20,945	25
TOTAL	312,981	384

Source: Nairobi City Council Office 2019

According to Kothari (2008), data collection main purpose is to obtain information needed to keep records, to decide subject issues, to pass the information on to others. The research utilized primary data. Closed-ended questionnaires were prepared and data collected using the drop and pick later method. The questionnaires had sections A-F whereby section A contained questions relating to personal information and section B-F comprised questions relating to the study variables, respectively. The questionnaires were designed according to the research objectives, where participants were expected to show the weight they attach to each factor perceived to be affecting financial inclusion among SMEs owners. After a pilot study, the findings were used to determine how accurate the research instrument was. On 10 percent of the sample, which was 38 participants, pre-testing was conducted. These respondents were owners of SMEs that operate in neighboring Kiambu County. Based on the evaluation, the instrument was properly modified before being subjected to the final data collection exercise. Reliability is determined by the degree of error in testing. The questionnaire was the subject of an overall internal consistency reliability analysis. The alpha (α) from Cronbach was used to assess the efficiency of the current research instrument. If the alpha coefficient of Cronbach is at or above 0.7, that would be calculated as sufficient reliability (Field, 2009). The overall alpha coefficient was 0.745, which was greater than the threshold of 0.7. This means that all the sub-variables were regarded as reliable.

All collected data were reviewed and cleaned to determine incorrect, incomplete, or unacceptable data and then improve the quality by correcting found errors and omissions to be analyzable (Mugenda, 2013). The collected data was analyzed using quantitative techniques with the help of Statistical Package for Social Sciences (SPSS vs 24.) and tables and charts were used to present the results. The study employed descriptive statistics such as means to analyze the data. To determine the significant associations among the study variables, inferential statistics including regression and correlation were used to test the study's significant effect. The correlation was used to determine the connection between the constructs. A multiple regression model was used

to assess the effect of the predictor variables on the dependent construct. The following model was used.

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \varepsilon \dots \dots \dots 3.1$$

Where; Y = Financial Inclusion

B0= y-intercept or constant,

B1- β_3 =Coefficients beta for each variable.

X1= Financial literacy

X2= Demographic characteristics

X3= Information Asymmetry

ε = is the error term or residual that cannot be explained by the model.

Hypothesis testing was carried out using regression analysis at 95% confidence level i.e $\alpha = .05$. Also, diagnostic tests were conducted to ensure that the study data was accurate and can be used for analysis. Diagnostic tests employed were normality, multicollinearity, and test of autocorrelation.

Results and Discussion

The main objective of this research was to determine factors affecting financial inclusion among small and medium enterprises owners in Nairobi County, Kenya. The response rate from the SMEs was 75.3% which was found to be satisfactory as previously explained by Mugenda and Mugenda (2003). Normality test was conducted using Shapiro-Wilk test and findings indicated P values greater than 0.05. This denoted that variables data was normally distribution. Multicollinearity test was done using Variance Inflation Factor (VIF) and results revealed an overall VIF value of 1.286 implying that the independent variables were not highly correlated.

Correlation analysis of factors affecting financial inclusion among SMEs owners in Nairobi County

The study conducted Pearson correlation coefficient analysis to determine the association between the study variables. The direction and strength of the relationship existing between the study variables were determined with the assumption that the data obtained from the study is normally distributed and continuous. The correlation analysis results were as shown in Table 2.

Table 2: Pearson correlation coefficient analysis results

		Financial Inclusion	Financial Literacy	Demographic Characteristics	Information Asymmetry
Financial Inclusion	Pearson Correlation	1			
	Sig. (2-tailed)				
	N	289			
Financial Literacy	Pearson Correlation	.613**	1		
	Sig. (2-tailed)	.000			
	N	289	289		
Demographic Characteristics	Pearson Correlation	.552**	.215**	1	
	Sig. (2-tailed)	.000	.000		
	N	289	289	289	
Information Asymmetry	Pearson Correlation	-.626**	-.525**	-.134*	1
	Sig. (2-tailed)	.000	.000	0.023	
	N	289	289	289	289

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

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

The findings in Table 2 indicate that there is a positive and significant correlation between financial literacy and financial inclusion ($r=0.613$, $P\text{-value} = 0.000$). The findings also show that demographic characteristics and financial inclusion have a strong and meaningful correlation ($r=0.552$, $P\text{-value} = 0.000$). Furthermore, the results reveal a negative and significant correlation between the asymmetry of information and financial inclusion ($r=-0.626$, $p\text{ value}=0.000$). The findings suggest that an increase in demographic characteristics and financial literacy is related to an increase in financial inclusion among owners of small and medium-sized enterprises in Nairobi County, Kenya. On the other hand, a rise in information asymmetry is correlated with a decrease in financial inclusion among small and medium-sized business owners.

Regression Results

To determine the relationship between financial literacy, demographic characteristics, and information asymmetry on financial inclusion among small and medium enterprises owners in Nairobi County, a multiple regression analysis was used to test the hypothesis. To determine the

fitness of the model, the F-statistic and the associated P-values were used in the study. The significance level of $P < 0.05$ was used to decide on whether to reject or accept the null hypothesis. The results were as illustrated in the Tables 3, 4 and 5.

Table 3: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.825 ^a	0.681	0.678	0.1941218

a. Predictor: (Constant), Information Asymmetry, Demographic Characteristic, Financial Literacy

The model summary results in table 3 show that there is a strong relationship between factors affecting financial inclusion among SMEs in Nairobi County ($R=0.825$). The adjusted R square for the model was 0.678 implying that 67.8% of the variations in financial inclusion among SMEs in Nairobi County were explained by changes in financial literacy, demographic characteristics, and information asymmetry. The remaining 32.2% of the variations in financial inclusion were explained by other factors not considered in the study.

Table 4 presents the ANOVA results.

Table 4: ANOVA

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	22.921	3	7.640	202.750	.000 ^b
	Residual	10.740	285	.038		
	Total	33.661	288			

a. Dependent Variable: Financial Inclusion

b. Predictor: (Constant), Information Asymmetry, Demographic Characteristic, Financial Literacy

The ANOVA findings in table 4 indicate that the model is reliable (a good fit for data) as supported by 202.75 F statistics and a P-value of $0.000 < 0.05$. This means that the model was fit to predict the combined effect of financial literacy, demographic information, and information asymmetry on financial inclusion among SMEs owners in Nairobi County. Further, based on the ANOVA results, the P-value = $0.000 < 0.05$ indicating a statistical significant relationship between financial literacy, demographic information and information asymmetry on financial inclusion among SMEs owners in Nairobi County hence the null hypothesis (H_0) which states that combined, financial literacy, demographic information, and information asymmetry have no significant relationship with financial inclusion among SMEs owners in Nairobi County was rejected and the alternative hypothesis which state that combined, financial literacy, demographic information, and information asymmetry have a significant relationship with financial inclusion among SMEs owners in Nairobi County was accepted. Table 5 shows the beta coefficient results.

Table 5: Coefficients

Model		B	Std. Error	t	Sig.
1	(Constant)	.672	.345	1.948	.052
	Financial Literacy	.353	.046	7.684	.000
	Demographic Characteristics	.628	.050	12.592	.000
	Information Asymmetry	-.488	.047	-10.354	.000

a. Dependent Variable: Financial Inclusion

The regression coefficient results in table 5 indicated that the constant, $\beta=0.672$; $P=0.052<0.05$, coefficient for financial literacy, $\beta=0.353$; $P=0.000<0.05$, coefficient for demographic characteristics, $\beta=0.628$; $P=0.000<0.05$, information asymmetry $\beta=-0.488$; $P=0.000<0.05$. Therefore, the multiple regression equation was summarized as follows;

$$\gamma = 0.672 + 0.353x_1 + 0.628x_2 - 0.488x_3$$

These findings imply that if all variables were held constant at zero, financial inclusion among SMEs owners in Nairobi County would be 0.672. Also, if all factors were held constant and financial literacy increased by one-unit, financial inclusion among SMEs owners in Nairobi County would increase by 0.353. Similarly, if all factors were held constant and demographic characteristics increased by one unit, financial inclusion among SMEs owners in Nairobi County would increase by 0.628. Moreover, information asymmetry had a negative coefficient implying that if all factors were held constant and information asymmetry increased by one unit, financial inclusion among SMEs owners in Nairobi County would decrease by 0.488.

Hypothesis testing

The first hypothesis (H01) that there is no significant relationship between financial literacy and financial inclusion among small and medium enterprises owners in Nairobi County, Kenya was rejected. This was supported by a t value of $7.684>1.96$ at 95% confidence interval. This means that financial literacy has a significant relationship with financial inclusion among small and medium enterprises owners in Nairobi County, Kenya.

The second hypothesis (H02) that there is no significant relationship between demographic characteristics and financial inclusion among small and medium enterprises owners in Nairobi County, Kenya was rejected. This was supported by a t value of $12.592>1.96$. This means that demographic characteristics have a significant relationship with financial inclusion among small and medium enterprises owners in Nairobi County, Kenya.

The third hypothesis (H03) that there is no significant relationship between information asymmetry and financial inclusion among small and medium enterprises owners in Nairobi County, Kenya was rejected. This was supported by a t value of $10.354>1.96$. This means that information asymmetry has a significant relationship with financial inclusion among small and medium enterprises owners in Nairobi County, Kenya.

Conclusions

This study made the following conclusions:

Firstly, financial literacy has a significant relationship with financial inclusion among owners of SMEs in Nairobi County. These conclusions are in line with the existing literature which shows that improvement in financial literacy of SMEs owners will increase their financial inclusion. Wafula (2017) found the relationship between saving practices, debt management, investment practices, financial planning services, and financial inclusion among smallholder farmers in Trans Nzoia County to be positive and relevant. Njehia (2014) determine the level of financial literacy of employees at Mumias Sugar Company and the impact of financial literacy on saving practices and preparation for social security. The research revealed that the majority of Mumias Sugar Company's employees have good financial expertise and skills experience. Maina (2010) found that financial literacy had a positive influence on personal financial activities. It is noted that the findings of this study are in line with those of other scholars which implies that the findings can be generalized in other studies.

Secondly, demographic characteristics had a direct and significant relationship with financial inclusion among owners of SMEs in Nairobi County. The conclusions on these variables were in line with the conclusions from the existing literature which indicated that the different attributes of business owners have a significant contribution to their financial inclusion. The empirical findings reviewed from other sectors had corresponding conclusions with the current study. Marime & Magweva (2016) found that age, class, educational level, and job status were statistically important while income was not considered to be statistically significant in impacting the levels of financial exclusion. Kiai, Ng'ang'a, Kinyanjui & Kiragu (2016) found that gender, sex, marital status, and level of education were statistically important in financially impacting youth including investment. Zins and Weill (2016) found that financial inclusion is decided by the higher economic and income impact of gender, sex, and economic rates. Therefore, the conclusions reached in this study can be generalized to other enterprises other than SMEs owners.

Thirdly, information asymmetry had an inverse and significant relationship on financial inclusion among SMEs owners in Nairobi County. The conclusions on these variables were in line with the conclusions from the existing literature which indicated that lack of adequate information by SMEs owners is a hindrance to their financial inclusion. The empirical findings reviewed from other sectors had corresponding conclusions with the current study. Huang, When & Liu (2014) found that asymmetry of knowledge contributes to adverse selection and a moral hazard. Therefore, the conclusions reached in this study can be generalized to other enterprises other than SMEs owners.

Fourthly, when combined, financial literacy, demographic characteristics, and information asymmetry had a significant relationship with financial inclusion among SMEs owners in Nairobi County. It was thus concluded that combined, financial literacy, demographic characteristics, and information asymmetry had a significant relationship with financial inclusion among SMEs owners in Nairobi County. Since these findings were consistent with findings in other studies conducted in a different context, the study concluded that the findings can be generalized to other contexts such as large businesses or unregistered enterprises.

Lastly, the government regulation had an overall negative moderating effect on the factors that affect financial inclusions among owners of small and medium-sized enterprises. The implication is that the available regulations aren't suitable for the SME market. The empirical findings reviewed from other sectors had corresponding conclusions with the current study. Therefore, the conclusions reached in this study can be generalized to other enterprises other than SMEs owners.

Recommendations

Based on the findings, the study makes several recommendations. The study established a significant direct influence of financial literacy on financial inclusion among owners of small and medium-sized enterprises in Nairobi County. This means that financial literacy is a critical factor in attaining financial inclusion. Based on these findings, it is recommended that SMEs owners should seek financial knowledge.

The study also established a significant direct influence of demographic characteristics on financial inclusion among owners of small and medium-sized enterprises in Nairobi County. Based on these findings, it is recommended that the government should ensure fair access to financial credit for everyone.

Further, the study established a significant indirect influence of information asymmetry on financial inclusion among owners of small and medium-sized enterprises in Nairobi County. This means that information asymmetry is a hindrance to financial inclusion. Based on these findings, it is recommended that the government should pass a statute that requires financial institutions to publish information regularly.

In addition, the study concluded that combined, financial literacy, demographic characteristics, and information asymmetry had a significant relationship with financial inclusion among SMEs owners in Nairobi County. Based on these findings, it is recommended that the owners of SMEs in Kenya and the government should seek to ensure that all SMEs are financially included to enable them access credit easily and make sound financial decisions.

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