

**EFFECT OF CAPITAL STRUCTURE ON FINANCIAL PERFORMANCE OF  
SMES FUNDED BY UWEZO FUND IN MERU COUNTY, KENYA**

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## DECLARATION AND APPROVAL

### Student's Declaration

This project is my original work and has not been presented for a degree in any other University or for any other award.

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### Approval by the supervisor

I confirm that the work reported in this research project was carried out by the candidate under my supervision.

Signature: 

Date: 1/11/2024

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## DEDICATION

I would want to dedicate this research to my dear family members, Lydiah, Nkatha, and Ntalala. They have always been there for me, offering moral, spiritual, emotional, and financial support, and they have been a source of inspiration and strength.



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## ABSTRACT

In a nutshell, a company's capital structure is the way it raises money for its day-to-day operations and future expansion. Financial literacy refers to the ability to comprehend and make use of financial information, whereas business financing refers to the method by which a firm acquires its assets through a mix of debt and equity. The direct effects of capital structure and financial literacy on the financial performance of small and medium firms sponsored by the Uwezo fund in Meru County, Kenya, have been the subject of varied conclusions in previous academic investigations. These contradictory findings point to the necessity for additional studies that develop theoretical frameworks for studying financial performance that take capital structure and financial literacy into account. To better understand the complex interplay between capital structure, financial literacy, and financial success, it may be helpful to include such variables. With the help of the Uwezo fund, this research set out to analyze the performance of SMEs in Meru County, Kenya, and how factors like capital structure and financial literacy influenced that success. This study zeroed in on uwezo fund-funded SMEs in Meru County, Kenya, and looked at how internal equity, debt financing, and retained earnings impacted their performance. Also, in Meru County, Kenya, the study aims to determine how much the Uwezo Fund's support for small and medium businesses impacts their performance. The research was founded on the theories of Modigliani and Miller, Market Timing, Static

Trade-off, and The Pecking Order. This descriptive study used Yamane's (1967) formula to determine that 329 people would be representative of the target demographic of 1859 SME owners in Meru County who have received Uwezo grants. Questionnaires were distributed to gather primary data, which was subsequently coded and analyzed using SPSS. Descriptive and inferential statistics were employed to examine quantitative data. The data was presented visually using figures and tables.

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## ABBREVIATIONS AND ACRONYMS

ANOVA	Analysis of Variance
EPS	profits per share
<b>GDP:</b>	Gross Domestic Product
<b>KNBS:</b>	Kenya National Bureau of Statistics
LTDF	long-term debt financing
M	M
MTT	market timing theory
NACOSTI	National Commission of Science, Technology, and Innovation
SPSS	Package for the Social Sciences
PASS	Private Agricultural Sector Support
POT	Pecking Order Theory
PSF	preferred stock financing
REO	return on equity
ROA	return on assets
SD	Standard Deviation
SDGs	Sustainable Development Goals
SEM	structural equation modelling
SMBs	small and medium-sized business owners
SME	small and medium-sized enterprise
SMEs	small and medium-sized businesses
<b>SMEs:</b>	Small and Medium-Sized Enterprise
STDF	short-term debt financing

## CHAPTER ONE

### INTRODUCTION

#### 1.1 Background to the Study

Capital structure decisions, which involve balancing debt and equity financing, are intricate and calls for thorough deliberation from company management (Kumar, Sureka & Colombage, 2020). A company's financial health is affected by the proportion of its funding that comes from internal sources as opposed to external sources. According to Doshi (2023), one way to understand a company's financial health is to look at its balance sheet. It shows all of the assets and liabilities of the business. Components such as ordinary stock, preferred stock, and long-term debt make up capital structure. According to Hamrayev (2023), companies strive to achieve optimal capital structure by making efficient use of capital and responding effectively to future events. Yet, it is not easy to determine the best combination of funding mechanisms. A capital structure that supports the financial goals of the organization can be achieved by careful consideration of available options by the management team.

You may measure the success or failure of a business by looking at its profitability and liquidity ratios, two important financial measures (Cho, Chung & Young, 2019). Subjective metrics point to good performance when a company is good at turning its assets into earnings. A model developed by Modigliani and Miller that associates the cost of bankruptcy with the amount of debt a company has was backed by Brusov, Filatova, and Orekhova (2022). Their research established a causal relationship between capital structure and the profitability of a company or other organization. Job creation, both formal and informal, is a key component of healthy economies around the world, and SMEs play a pivotal role in this.

More than half of Africa's jobs and thirty percent of the continent's GDP come from SMEs (Capital Market Authority, 2021). Similarly, SMEs generate 62% of employment and 64% of GDP in high-income nations (Tekola & Gidey, 2019). In 2019, 85% of the new jobs in Kenya were created by SMEs (Osano, 2019). Nevertheless, Motta (2020) states that a key reason SMEs fail is a lack of access to external funding, even though these factors are important. Production efficiency and profit margins are two things that all firms, no matter how little, strive to improve. Capital structure, defined as the particular ratio of debt to equity that a firm employs to finance its operations, is one variable that might affect operational profitability and efficiency (Dhiab et al., 2022). Consequently, the goal of financial managers is to maximize profits while minimizing costs via optimizing capital structure. In order to prosper, provide jobs, and propel economic progress, SMEs in Africa must have access to capital.

Despite the importance of their ventures, microenterprises run by Kenyans encounter a number of obstacles. Three out of five new firms fail within the first few months of operation, and the bulk of these companies do not survive the first five years (Kenya National Bureau of Statistics, 2019).

As part of its Vision 2030 strategy, Kenya established the Uwezo Fund. Funding for women, youth, and persons with disabilities at the constituency level is its primary objective. They are able to launch and expand their firms and enterprises thanks to this funding. Entrepreneurship is one of the program's stated goals for these demographics. The creation of the Uwezo Fund has reportedly made it easier for rural entrepreneurs to receive microcredit (Ikonya, 2019). For many entrepreneurs, getting startup funding is a huge obstacle, thus this is really important. The Uwezo Fund disperses its monies directly to local levels, in contrast to other development funds that pass through multiple bureaucratic and administrative hoops after leaving the federal government. By increasing opportunities for youth and women-owned enterprises and lowering barriers to entry, this

strategy hopes to empower locals to take charge of their own economic futures. Businesses are able to take advantage of sustainable financial services because to the low interest rates, which start at zero percent and go up to one percent. We aim to promote self-sufficiency and achieve financial stability by requiring those who access the Uwezo Fund to undertake financial literacy training before getting the monies.

One definition of financial literacy is "the ability to understand and make sound decisions based on one's own personal financial situation" (Rohayati et al., 2020). It involves knowing the fundamentals of asset protection, inventory management, investing, and debt management (Kovács & Terták, 2019). Additionally, a more inclusive definition was suggested in the study, and it has since gained widespread acceptance. By enhancing comprehension and self-assurance in using financial services, financial literacy is believed to have a strong, beneficial influence on spending, saving, and borrowing (Grohmann, 2018). Because they are more self-aware, knowledgeable, and confident when it comes to financial information and products, people who are financially literate generally make better decisions when it comes to their money and finance.

### **1.1.1 Capital Structure**

The capital structure of a corporation is the interplay of its many funding mechanisms (Ngambi & Wake, 2015). Corporate financial management and strategy heavily relies on determining the ideal debt-to-equity ratio (Maina & Kondongo, 2013). According to Friend (2008), a company's capital structure includes the mix of stock and debt financing that it thinks will help it operate better. The total cost of capital and the value of the company are affected by this combination. Deakins, Whittam, and Wyper (2010) classify sources of company funding as either internal or external. Factors that are considered internal include things like retained profits, personal savings, credit, the sale of assets, working capital, and donations from friends and family. To the outside world, there is the issue of debt and stock (Titman, Keown & Martin, 2011).

Capital structure is determined by both firm-specific characteristics like size and profitability and macroeconomic variables like inflation and interest rates (Krénuusz, 2005). When compared to equity holders, debt investors enjoy contractual protections, set returns, and limited influence (Ngambi & Wake, 2015). When deciding between debt and equity financing, companies consider a number of issues. Operating cash flow is allocated between debt servicing and shareholder payments based on a capital structure configuration (Chowdhury & Chowdhury, 2010).

An organization's capital composition and its volatility are influenced by various funding mechanisms (Brusov et al., 2022). Companies might choose to issue a lot of debt or a lot of equity, thus it's important to find the sweet spot between the two to maximize their market value (Afinindy, Salim & Ratnawati, 2021). Debt financing comprises borrowing money from outside parties like creditors and taking out loans, whereas equity financing comprises investors actually becoming partners in the business (Nyanamba, 2019). Strategies for achieving an appropriate capital structure for the firm include reducing the use of debt for funding SMEs, as interest payments are a common expense of debt (Nyanamba, 2019). Although taking on more debt can increase the ROE, it also increases the chance of financial losses. Mwangi (2021) asserts that in today's dynamic market economy, businesses adapt their capital structures to remain comprehensively competitive by taking into account both internal and external factors.

Equity financing, family loans, debt financing, and capital and retained earnings are the four main categories into which Rubunda, Namusonge, and Oluoch (2019) classify capital structure. Whereas, according to Miglo (2016), there are five primary categories of capital structure: owner's equity, debt from related parties, trade credit, bank loans, and alternative equity and debt forms such credit cards, venture capital, and government support. The capital structure of a firm is the unique combination of equity capital and long-term debt instruments that it employs to fund its assets and operations. The financial

architecture of a company reveals its funding techniques and where the money is coming from throughout time.

### **1.1.2 Financial Literacy**

To be financially literate is to have the information and abilities that allow one to manage one's own money wisely and effectively. Among these skills is the ability to effectively manage one's own money, which involves making sound choices about investments, insurance, housing, education costs, spending, saving, and taxes (Rohayati et al., 2020). In addition, as Kovács and Terták (2019) point out, being financially literate Ms knowing how to budget, how to handle debt, how to save money effectively, and how to calculate the time value of money. It includes knowing how to use banking services effectively, creating and sticking to a budget, and keeping accurate books.

The goal of debt management is to help people and companies have a better grip on their financial obligations. You might think of a budget as a financial plan that lays out the money coming in and going out of a business over a certain time period (Yeh, 2022). Bookkeeping, according to Lewis, Mayala, and Ogoti (2023), is an essential part of accounting since it involves keeping track of all the money that comes in and goes out of a company. For managerial guidance, decision-making, policy-making, and stakeholder relationship maintenance, records-keeping is critical. Furthermore, as pointed out by Rohayati et al. (2020), firms may better manage their finances, have access to credit, and deposit funds securely when they have banking knowledge.

Poor financial decisions, brought on by a lack of knowledge or understanding of personal finance, can have a devastating effect on a person's financial security. As pointed out by Esiebugie, Richard, and Emmanuel (2018), financial literacy is crucial, especially for SMEs. They say that being financially literate involves being able to manage one's money well, having a positive attitude towards responsible money management, and being able to make good decisions based on one's knowledge. Having this skill Ms you can talk about

money and financial issues without feeling awkward, and you can read, analyse, manage, and communicate personal financial conditions that impact your well-being (Ani, Kelmara & Wesley, 2016). The ability to understand and manage one's own money is a key component of financial wellness and the ability to make sound decisions. Financial literacy is now crucial for organizations and enterprises to operate efficiently in today's complicated and constantly changing business climate. Governments across the globe are proactively looking for ways to raise the level of financial literacy among their populations, as pointed out by Abitoye et al., (2023). Approaches to financial education that provide a range of learning opportunities are central to their plans to reach this objective. As a means of boosting the general public's financial literacy, numerous nations have instituted financial education programs (Tali, 2016). Knowledge of this topic is essential in the modern world because it allows people to make educated decisions about their money and helps keep the state and society financially stable.

### **1.1.3 Performance of SMEs**

A micro-enterprise is a tiny business that is usually registered and has five employees or fewer with an initial capital of up to \$35,000. Expanding the enterprise's activities as seen by increasing sales, income, and assets is what Bravo-Biosca, Criscuolo, and Menon (2016) mean when they say performance in this context. For most small businesses, expanding into bigger companies and increasing shareholder wealth is the ultimate goal. Many things impact a company's success, including its stage in the lifecycle, the state of the industry, and the owners' goals for the generation of equity value. Enterprises enhance specific successes through performance, according to Storey (2016). This process is in line with the goals of maximizing profit and shareholder wealth. An organization's success can be measured by its revenue, which can be increased by the sale of more products or the provision of more services, or its profitability, which can be enhanced by

the reduction of expenses. Asset growth, sales growth, and profit or income expansion are important measures of a company's performance (Koryak et al., 2015).

The sales team's ability to increase revenue over a given time period is measured by sales performance, which is important for the company's financial health and survival (Bekaert and Hodrick, 2017). Furthermore, as highlighted by Storey (2016), sales performance shows the rise in revenue over a given time frame, which is often expressed as a percentage increase in a company's average sales volume, often compared to the previous year. In order to assess sales growth with precision, a company requires sales revenue data that is both current and historical. Asset performance, on the other hand, is a reflection of the growth in the firm's total assets, according to Banerjee (2015). At the outset, small enterprises often have fewer assets, but this number rises as the company expands. Determining assets growth, like evaluating sales growth, necessitates comparing the firm's assets from one time to another.

A rise in a company's net income, sometimes called profit growth, shows that its profit statistics have been increasing (Petty, Zuckerberg & Pauli, 2015). Maximizing profits is the fundamental goal of every business. This is accomplished by strengthening the ability to increase sales and improve competitive positioning. After deducting expenses, the remaining sum is the profit or income for a corporation. From one time period to another, whether it's a year or a month, profits can vary. The expansion of earnings from one period to the next can be seen by analysts using a percent-change calculation (Banerjee, 2015).

The present study evaluated the performance of small and medium firms using three growth indicators: assets, revenue (sales), and profit.

#### **1.1.4 Uwezo Fund**

An important program in Kenya's Vision 2030 is the Uwezo Fund, which aims to help people with disabilities, young people, and women have access to financial services on a local level. Aiming to promote gender equality and empower women and SDG 1 to

eradicate extreme poverty and hunger, the program seeks to encourage the expansion of businesses and enterprises. This, in turn, contributes to economic advancement and is in line with the SDGs. Uhuru Kenyatta, Kenya's president, launched the Uwezo Fund on September 8, 2013, and it was officially constituted by Legal Notice No. 21 of the Public Finance Management Act, 2014, which was published on February 21, 2014 (Buyema, 2013). Unused Kshs. 6 billion from the presidential run-off election is what the Uwezo Fund uses as its funding source (Obonyo, 2014). Because of its constituency-based distribution model, the Uwezo Fund is open to women, people with disabilities, and youth groups (Buyema, 2013). At the national level, the Uwezo Fund is managed, designed, and overseen by the National Uwezo Fund Oversight Board. In each of Kenya's 290 constituencies, the fund is put into action by the Constituency Uwezo Fund Management Committees, which are also responsible for tracking its progress.

#### **1.1.5 SMEs in Meru County**

Government of Kenya (2012) defines a microenterprise as a business activity, firm, trade, or industry with ten or fewer employees and an annual turnover of five hundred thousand shillings or less. The industry is highly vital to the Kenyan economy, as it accounts for over 40% of the country's GDP and almost 82% of the total employment (KNBS, 2019). With almost 25% of Kenya's total employment in SMEs located in Meru County, the county stands out for its respectable amount of SMEs (KNBS, 2019).

County authorities in Meru view informal traders as dangers to the county's growth, therefore they fail to adequately regulate and assist SMEs and the informal sector, despite the sector's critical role in the county's economy. Not only do SMEs in Meru County face external hurdles, but Kathono (2019) notes that a lack of financial literacy, restricted access to capital, and high transaction costs are all major obstacles. After reviewing the literature on the topic, we have identified conceptual, contextual, and empirical gaps in

our knowledge of the processes at play when it comes to financial literacy, financial access, transaction costs, and the performance of SMEs.

## **1.2 Statement of The Problem**

Whether in a developed or developing nation, microenterprises are a driving force behind economic growth because of the jobs they create, the connections they bring to markets across industries, the innovations they inspire, the money they save, and the amount of GDP they add (Tekola & Gidey, 2019). More than 42% of Kenya's gross domestic product (GDP) and half of the country's employment are created by these small businesses (Kidali, 2020). Omondi and Jagongo (2018) notes that many Kenyan entrepreneurs face obstacles including inadequate financial literacy, restricted access to financial services, and high transaction costs, despite the fact that these entrepreneurs are economically significant. These difficulties contribute to the widespread "missing middle" phenomena in the economy by lowering the rates of new venture development, graduation, and microenterprise failure (Mokua, 2019). The Uwezo Fund has seen rising annual fiscal allocations from the national treasury as the Kenyan government has stepped up its support for SMEs in light of the growing importance of microenterprises (Uwezo Fund Status Report, 2018). Microenterprises fail at a significant rate worldwide, even though the Uwezo Fund distributed about Sh5.8 billion to around 960,000 recipients.

Inadequate capital structure and infrastructure, along with incompetent management, can lead to a failure rate of up to 63% in the first two years of business (Bushe, 2019). A lack of financial literacy is also a major cause. Some of these SMEs have sought for additional funding from a variety of sources to make up the shortfall, leading to a variety of capital structures, which is another consequence of their low capital. The effect of capital structure and financial literacy on the financial performance of SMEs has been the subject of both converging and diverging viewpoints in a number of empirical research.

According to multiple academics (Li, Niskanen, & Niskanen, 2019; Delikanlı & Kılıç, 2021; Chikeya, 2019; Mwangi, 2021), the impact of capital structure on the performance of small and medium-sized enterprises confirms this.

Esiebugie, Richard & Emmanuel (2018), Agyei (2018), and Usama & Yusoff (2019) all found that those who are financially literate are less likely to get into debt, save more money, and build wealth. The president's Big Four Agenda and Vision 2030 both recognize the importance of financial literacy, but there is a dearth of data on how capital structure and financial literacy affect the success of SMEs that have received start-up or growth funding from the Uwezo Fund. This research aims to fill that information vacuum by investigating how SMEs in Meru County, Kenya, that received funding from the Uwezo Fund fared in relation to financial literacy and capital structure.

### **1.3 Purpose of The Study**

The goal of the study was to ascertain how capital structure affected the financial performance of SMEs in Meru County, Kenya, that were supported by the Uwezo Fund.

### **1.4 Specific Objectives of the Study**

The objectives of the research were as follows:

- i. To examine the effect of internal equity financing on financial performance of Uwezo fund-funded SMEs in Meru County, Kenya
- ii. To assess the effect of debt financing on financial performance of Uwezo fundfunded SMEs in Meru County, Kenya
- iii. To determine the effect of retain earnings on financial performance of Uwezo fund-funded SMEs in Meru County, Kenya
- iv. To explore effect of financial literacy on the financial performance of Uwezo

Fund funded SMEs in Meru County, Kenya.

### **1.5 Research Questions**

For this study, the following questions formed the framework:

- i. How does the internal equity financing affect the financial performance of small and medium firms funded by Uwezo funds in Meru County, Kenya? ii. In Meru County, Kenya, what effect does debt financing have on the financial performance of SMEs that have received Uwezo fund funding?
- iii. What is the effect of retain earnings on financial performance of Uwezo funded SMEs in Meru County, iv. In Meru County, Kenya, how does the level of financial literacy impact the financial performance of SMEs that get funding from the Uwezo Fund?

## **1.6 Significance of the Study**

This research is important for different sets of stakeholders who have the potential to acquire valuable insights. These groups encompass owners of SMEs, policymakers, as well as scholars and academicians.

### **1.6.1 SME Owners**

The outcomes of the research aspire to furnish significant information to SME owners, providing them with insights into how capital structure and financial literacy affect the performance of their businesses.

SMBs can do a better job of running their companies if they educate themselves on financial matters.

### **1.6.2 Policymakers**

With a better grasp of the ways in which capital structure and financial literacy impact the success of SMEs, the study's findings are also highly valuable to policymakers. Policymakers can utilize these insights to devise strategies for educating SME owners on financial matters, enabling them to adeptly manage their business finances.

### **1.6.3 Academicians and Scholars**

Research on the relationship between capital structure, financial literacy, and SME success was expected to add significantly to what is already known. The study has the

potential to shed new light on financial literature for academics and scholars, while also providing a solid foundation for further research in the field.

### **1.7 Scope of the Study**

The primary goal of this study was to examine how SMEs in Meru County, Kenya, that were recipients of Uwezo Fund investment fared operationally as a result of factors including capital structure and financial literacy. With a total of 1859 firms, Meru is home to a large number of SMEs and ranks high among the regions that have received funding from the Uwezo Fund. The study's overarching goal is to assess how capital structure and financial literacy impacted the success of SMEs in Meru County that received funding from the Uwezo Fund. Owners of SMEs in Meru County who have been granted funds by the Uwezo Fund were the sole subjects of the research. The proprietors of these businesses were the units of observation, whereas SMEs were the units of analysis. In order to evaluate these SMEs' performance, the study gathered financial data from 2018 to 2023.

### **1.8 Limitations of the Study**

Owners and managers of SMEs provided information about their financial literacy and company performance through self-reporting. This data was subjected to social desirability, recall, or other biases. As the study was limited to SMEs receiving Uwezo funding in Meru County, the findings may not be generalizable to SMEs in other counties or countries. The response rate to questionnaires or interviews was low, posing challenges for drawing conclusions or generalizing the findings, the researcher was mitigate this by use of drop and pick method of data collection and constantly reminding the respondents with SMs and phone calls where necessary.

### **1.9 Delimitations of the Study**

The SMEs in Meru County that received funding from the Uwezo program were the primary subjects of this research. Results and interpretations may not apply or be

generalizable to SMEs outside of Meru County because this study was conducted inside that specific setting. The impact of financial literacy on the performance of SMEs supported by Uwezo funds from 2018 to 2023 is the sole subject of this time-limited study. Considering that legislation, economic situations, and financial literacy initiatives can change over time, the temporal scope is useful for shedding light on the particular variables that were in play during the specified period. The focus of this study was on SMEs who have benefited financially from the Uwezo grants. Neither other funding sources nor financial entities were considered in the study's expansion of its scope. Focusing on Uwezo funds allows for a more thorough assessment of the correlation between financial literacy and the success of SMEs in Meru County's specific funding program.

#### **1.10 Assumptions of the Study**

Participants were expected to provide accurate, real, and true information as the research progressed. It was also expected that responders would be cooperative and honest in providing the necessary information to support the research goals. Additionally, the survey was based on the assumption that the respondents were involved in the management of their businesses and had some knowledge of financial literacy. When analysing the results, the researchers also presumed that the sample size was large enough to be representative of the whole population.

#### **1.11 Operational Definition of Key Terms**

**Capital Structure:** Concerns the breakdown of the capital that is put into use. According to this research (Murtala et al., 2018), it is a combination of common stock, retained profits, and debt financing).

**Financial literacy:**

refers to the skills, knowledge, and confidence needed to handle one's financial affairs well, taking into account one's unique social and economic conditions. "Knowledge" refers, in particular, to an in-depth familiarity with one's own financial situation. "Skills" refers to the capacity to put such information into practice in order to manage one's own financial affairs. The term "confidence" is defined as the state of mind that allows one to make sound choices about their own financial well-being (Bharathi, 2023)).

**Financial Performance:**

provide a hard and fast indicator of how well the company's leadership is making do with its meager resources in order to increase profits. Strategies that SMEs use to invest their available funds in ways that provide returns and help their businesses develop. Measured by profitability levels in different time periods (Matar & Eneizan, 2018).

**Internal Equity Earning:**

this is the raising of capital for a business from sources that are already within the company itself, without obtaining funds from external investors or lenders. In this study the SMEs raise capital from the member's contribution and sale of assets (Njeru, 2014).

**SMEs:**

SMEs are defined in this article as privately held companies with a critical need for capital but no assets to put up as security with a bank or other lending institution.

**Uwezo Fund:**

A flagship program in line with Vision 2030, this one seeks to increase the number of local firms and entrepreneurs run by women, youth, and people with

disabilities by making it easier for them to get loans. In the end, we want to see more economic growth so that we can achieve Sustainable Development Goal 1.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.1 Introduction**

This part talks about the results of the study on capital structure. It includes a review of the existing research on the subject and how it affects the success of small businesses. As part of the theory study, we will look at internal stock financing, loan financing, kept earnings, and how knowing about money affects performance. This chapter also has the philosophical structure and an overview of the literature study.

#### **2.2 Theoretical Literature**

The success of small businesses in Meru County, Kenya, funded by the Uwezo Fund was looked at in this study. Theories like Modigliani and Miller's, MTT, Static Trade-off Theory, and The POT were used to do this. The four different ideas were used to reach the four different goals..

##### **2.2.1 MM theory (Modigliani and Miller)**

In a perfect market free of taxes and transaction costs, the value of a debt-ridden company (a "levered firm") is the same as that of an unindebted company (an "unlevered firm"), say Modigliani and Miller (1958). These two propositions provided an overview of the idea: Two Hypotheses: I and II. In Proposition I, they examined two firms with identical assets operating in the same market segment, having the same market share. Since these firms belonged to the same industry and encountered comparable competitive and business circumstances, and were exposed to similar business risks, it was anticipated that they would generate the same net operating income.

It can be deduced that regardless of whether two identical firms are solely equity financed or one is entirely equity financed while the other employs a mix of 50% equity and 50% debt, investors would anticipate the same rates of return or opportunity cost of capital for both. According to MM Proposition I, firms with equivalent net operating income and business risks but varying capital structures should possess equivalent value. The total market value of firms within the same risk category remains unaffected by the mix of financing (debt-equity), as the expected net operating income is capitalized at a uniform rate, representing the opportunity cost of capital for both leveraged and unleveraged firms.

Firms' market values are preserved independent of their gearing levels because investors can restore market equilibrium through arbitrage mechanisms by adjusting their personal gearing to counteract corporate gearing. Because it has no bearing on the firm's financial performance or the production of wealth for shareholders, the financing decision—also known as the capital structure—becomes irrelevant in this setting.

Financial leverage influences returns for shareholders, which in turn affects measures like ROE and EPS. According to Bierman and Hausman (1970), the aim of leveraging is to increase the value of a company. Earnings per share and ROE could increase with leverage if the interest rate paid on debt is less than the ROA of the company. A downside of financial gearing is that it increases the risk of loss for shareholders by making earnings per share and ROE more volatile (Solomon & Pringel, 1978). While gearing can boost profits for shareholders, it also increases their financial risk. In response to this heightened financial risk, shareholders may want a greater return (cost of equity) on their investments. Therefore, shareholders want a higher rate of return or cost of stock when financial risk is high.

For an ungeared (i.e., debt-free) business, the potential cost of capital is equal to its cost of equity, as stated by Modigliani and Miller (1958). The opportunity cost of capital stays

the same for geared firms, on the other hand, because the cost of equity goes up to offset the benefit of lower debt payments. Given that corporations are subject to taxation in every country, their theory cannot be applied since it presupposes the non-existence of such taxes. Businesses that use debt financing often end up paying less in taxes since interest payments to creditors are deductible. This is due to the fact that corporations are subject to income taxes. Because of this dynamic, debt financing is desirable in practical corporate finance contexts (Brealey & Myers, 1991).

The tax deductibility of interest costs boosts the worth of a firm when debt is included into its structure, according to Modigliani and Miller (1963). So, a geared firm, which uses debt, is usually worth more than an ungeared firm. Personal taxes, however, can reduce earnings for owners of a geared corporation. Theory of capital structure that followed conventional and Modigliani-Miller included trade-off, pecking order, agency, and market timing, among others. This gearing topic is relevant to the study because it shows how, to an investor, geared and ungeared enterprises look to be of equal value.

### **2.2.2 MTT**

Baker and Wurgler were the ones who first proposed the MTT (2002). If the cost of equity is low, firms will choose external equity, according to the hypothesis (Huang & Ritter, 2004). If the cost of equity is high, firms will prefer debt financing. Managers attempting to time the equity markets by issuing and repurchasing shares at high market prices or by issuing debt at low market prices leads to capital structure, according to this idea (Salminen, 2013).

Companies are more likely to buy back their own shares when their valuations are low and issue new ones when they're high, according to the MTT (Baker & Wurgler, 2002). By adopting this approach, companies can make the most of advantageous market circumstances while reducing the expense of equity financing. Firms that use retained earnings or owner money as their primary source of equity financing may do better

financially, if this theory is to be believed. They can keep a better capital structure and maybe reduce their total cost of capital by not seeking outside funding when market valuations are low (Hovakimian et al., 2001).

SMEs supported by the Uwezo Fund may not find the MTT very useful, though, because these businesses typically do not have easy access to public equity markets. However, the fundamental idea of when to raise capital through internal equity financing in order to optimize capital structure and reduce financing costs may remain applicable. Retained earnings or owner contributions, which are forms of internal equity financing, can be very important SMEs that get funding from the Uwezo Fund. This can help them keep a favorable capital structure and improve their financial performance. SMEs can save money by funding operations with internal equity instead of seeking expensive and often difficult-to-obtain outside funding like bank loans or venture capital (Berger & Udell, 1998).

SMEs supported by the Uwezo Fund may find some relevance in the principles of the MTT, which were initially formulated for use with public firms and equity markets. These principles pertain to the timing of equity financing and how it affects capital structure and financial performance.

### **2.2.3 Static Trade off Theory**

In 1958, Modigliani and Miller were the first to formulate this hypothesis. According to Drodetz and Wenzelried (2006), a debt equity ratio target is reached when the benefits of debt are outweighed by the costs of existing market flaws. Various writers have used this notion to characterize a group of interconnected theories.

In each of these models, a company's decision-maker weighs the pros and cons of potential leverage strategies. To achieve a balance between marginal cost and marginal gain, it is often believed that an inner solution is found. The incorporation of corporate income tax into irrelevance theory sprang from the dispute over the Modigliani and Miller

theorem. This development favored debt as a tax haven for firms' profits due to the linear nature of their objective functions and the absence of an offsetting cost of debt, which Mt that firms could finance themselves entirely through debt (Caroline & Willy, 2015). According to this school of thought, every given business can benefit from a capital structure that strikes a balance between maximizing value and minimizing cost of capital. According to Ogebe, Ogebe, and Alewi (2013), this theory states that a company's worth changes depending on its capital structure.

Until the risk of insolvency and financial hardship exceeds the tax benefit of debt, firms will choose debt over equity (Gill, Biger, Mand & Shah, 2012). Filing for bankruptcy is affected to a lesser extent by debt. An organization's risk of insolvency rises when it takes on debt because of the costs it incurs, both direct and indirect. Administrative and legal fees are examples of direct costs. A company may incur indirect costs if they do not plan to go bankrupt (Jaffe, Ross & Westerfield, 2009). Debt is advantageous because of the tax protection it provides, but it also puts the company at risk of financial trouble (Wanyoike, 2015). Beyond the ideal point, the likelihood of default on debt grows as debt levels rise. Debt financiers will attempt to reclaim their investment through the bankruptcy procedure if the firm fails to repay the loan (Anthony, 2013). This will transfer ownership of the firm from its owners to the financiers.

#### **2.2.4 The POT**

According to Altin (2022), the POT was first proposed in 1984 by Myers and Majluf. Companies should use their own resources before turning to debt or issuing new shares of stock, according to this approach. It functions on the premise that companies lack a clear objective regarding their financial structure. According to Mushipe (2017), the theory essentially states that corporations prefer using retained earnings first, then debt, and last seeking external capital. The relative costs of accessible funding sources,

primarily as a result of information imbalances between the company and possible financiers, impact this preference, according to Nyanamba (2019).

Since companies use their own resources first and then turn to debt as a last resort for financing, the POT predicts that the debt ratio will have a negative link with profitability (Mushipe, 2017). Based on this principle, organizations that are doing well financially should have lower debt loads than those that are struggling (Altin, 2022). The reason behind this is that, unlike debt, which causes the corporation to incur additional interest obligations, cash derived from earnings do not dilute ownership. Since the pecking order hypothesis ranks retained earnings as the most preferred form of equity and the issuing of new shares as the least preferred form of equity, it posits that there is no ideal debt-equity combination (Myers, 1984). A more optimal capital structure, according to the theory (Mwirikia, 2021), is attained when the costs of financial distress marginally outweigh the tax benefits of borrowing (the tax shield). The theory is summarized by Myers (1984) who highlights that there is no ideal debt-equity ratio because retained earnings are the preferred equity form at the top of the hierarchy and new share issuance is at the bottom. According to Myers (1984), the variables that determine the best leverage are overshadowed by asymmetric knowledge and transaction costs in the trade-off models. To avoid or reduce these borrowing costs, businesses often use their own cash flow to fund investments. Only in the event of a residual funding need is external capital looked for, and the procedure is as follows: first, safe debt, then hazardous debt, and lastly, equity issue. POT disagrees with trade-off theory in that it states that a desired capital structure does not exist for the long run (Maina & Kondongo, 2013). Different equity sources are prioritized by the POT, such as retained earnings rather than the issuing of new shares, so the idea of an ideal debt-equity mix is rejected (Myers, 1984).

Due of the substantial informational asymmetries, the POT is especially pertinent to privately held, small businesses (Coleman, 2006). This is due to the fact that these

companies usually refrain from disclosing their annual reports, making their financial figures inaccessible to the general public. The POT could only provide a partial explanation for the financing behavior of small biotech firms in Finland, according to Tahvanainen's (2003) research. This is because financial institutions do not have complete knowledge of the firm's financial situation, which worsens information asymmetry, increases risk, and drives up external capital costs. Bigger companies are more likely to have larger debt ratios than small companies, according to Delikanlı and Kılıç (2021), while profitable Turkish enterprises prefer lower debt levels. This suggests that Turkish enterprises are behaving in accordance with the pecking-order theory when it comes to their debt, and that TOT fails to adequately explain their capital structure compared to the pecking order hypothesis.

Businesses that have a lot of cash on hand use debt financing less often, according to research by Franquesa and Vera (2021). This provides more evidence that these businesses follow the POT's recommended financial structure. Companies that are very liquid usually have a lot of current assets, which means they get a lot of money coming in. Because of this, they are able to meet their operational and financing needs with these inflows, cutting down on their need for loan capital. These businesses are following the POT's guidelines by favoring internal funding over taking out loans from outside sources. According to D'Amato (2020), small enterprises often borrow money based on their immediate investment needs instead of aiming for an optimal capital structure, hence the POT is especially relevant to them.

Within the context of this research, this theory is relevant because it provides a framework for determining whether or not craft micro-enterprises make full use of their own capital before turning to external sources of funding. This theory states that micro-enterprises can first try to fund themselves through internal means, like selling assets or using profits, before looking for external ways, like loans from commercial banks, overdrafts from banks,

community welfare groups, the Uwezo Fund, development bank loans, or supplier credit. This inclination arises from the belief that funding from inside is usually more affordable than taking out a loan. Several earlier investigations of capital structure have benefited from this theory; for example, Nyanamba (2019), Oktavina, Manalu and Yuniarti (2018), Ogieva and Ogiemudia (2019), and Daskalakis and Psillaki (2008).

### **2.3 Empirical Literature Review**

SME performance as it relates to capital structure and financial literacy will be examined in the current empirical research. In particular, the study's objectives served as a roadmap for a literature evaluation that focused on SME financial literacy and performance, loan and equity financing, retained earnings, and internal equity financing.

#### **2.3.1 Internal Equity Financing and Performance of SMEs**

When a company uses its owners' own money or retained earnings to fund its operations and expansion, this is called internal equity financing (Abdulsaleh & Worthington, 2013). Due to factors including informational asymmetries, perceived higher risk, and a lack of collateral, SMEs sometimes encounter difficulties when trying to access external financing sources like capital markets or bank loans (Fatoki, 2014). Because of this, internal equity funding is a lifeline for many SMEs, even though it could hurt their performance.

Since they are often more affordable and maybe quicker to set up on short notice, a company's internal sources of funding are frequently better (Koch & Macdonald, 2000 as cited in Njeru, 2013). Individual savings, earnings, asset sales (or leasebacks), and savings from reduced capital constitute the primary sources of internal finance (Njeru, 2014). According to Nawi (2015), personal savings can come from a variety of places, such as the owner's own money, personal loans, credit, winnings, inheritance, or investment profits. Funds from family and friends are crucial SMEs, according to Ajibola (2020). This is particularly true for businesses owned by ethnic minorities or family businesses.

Garcia-Martinez et al. (2023) looked at the factors that significantly affect the development and success of SMEs in countries in Central and Eastern Europe that are experiencing fast expansion. Finding out what factors are most important SMEs to grow in this area was their main research goal. The researchers achieved this by drawing on a panel dataset that included 560 rapidly expanding SMEs from six distinct Central and Eastern European transition economies. Several elements were shown to be crucial in deciding a firm's growth and overall performance, according to the study. Among these crucial considerations were the following: the firm's factor productivity levels, its liquidity situation, the availability of money created internally, and the likelihood of future growth chances. There was no discernible correlation between the age of a company or its ownership structure and its rate of growth, according to the research. Governments in Central and Eastern European transition economies should prioritize supporting and nurturing the development of SMEs, according to the study. In particular, the authors argued that SMEs could be better served and perhaps thrive in an environment designed to meet their specific requirements.

With an emphasis on internal equity financing, Wieczorek-Kosmala, Błach, and Trzęsiok (2020) sought to survey the literature on financing small and medium-sized enterprises. They used a qualitative methodology that included a thorough literature review and synthesis for their investigation. The authors used the POT (Myers & Majluf, 1984) to analyse why SMEs prefer to raise equity from within the company.

For their 2020 study, Baker, Kumar, and Rao set out to investigate how SMEs in India's Northwest approach and use funding. In addition to documenting the drivers of financing practices, the study aimed to analyse disparities in financing preferences across company and owner/manager characteristics. In order to gather primary data from 309 SMEs, the study used a structured questionnaire. According to the results, people would rather have their own money. They frequently forego official short- and long-term funding sources,

despite their preference for them. Rather, they depend on trade credit, donations from loved ones, and money from moneylenders.

In 2014, Fatoki looked examined the financing preferences and challenges of SMEs in South Africa. Using a survey-based technique, the study collected data from SME owners and managers, employing a quantitative methodology. In order to investigate how various forms of funding, including internal equity financing, affect key performance indicators like growth and profitability, the author employed descriptive statistics and regression analysis. Using the POT as a framework, the research found that internal equity financing was crucial SMEs in South Africa.

Researchers Muturi and Njeru (2019) looked at the effects of various funding mechanisms on the bottom lines of Kenyan SMEs. Nairobi, Mombasa, Machakos, Makueni, Kajiado, and Kitui were the six counties in which 384 respondents were chosen at random from a pool of 291,449 licensed SMEs. Structured questionnaires were used to gather primary data, which was supplemented with secondary data. The data was analyzed using statistical approaches, which included both descriptive and inferential analysis. The results showed that equity financing had the strongest link with SME financial performance in Kenya, and that there was a significant correlation between the two. Researchers in Kenya found that SMEs do not rely on any one funding source to dictate their financial success.

In the course of researching how SMEs in Garissa County, Kenya, fared financially after receiving equity funding, Noor and Simiyu (2020) conducted a study in Garissa County that focused on 3097 SMEs. The study was supported by market timing chain and POT. The study's main data was gathered by a structured questionnaire, following a descriptive research methodology. It turned out that choosing Angel investors didn't cost much. According to the research, most SMEs rely heavily on retained revenues as a source of funding. In the past, retained earnings were a common source of funding for most SMEs

in Garissa. Many SMEs in Garissa County were able to lower their interest rates by keeping some of their profits.

### **2.3.2 Debt Financing and Performance of SMEs**

Kenyan small enterprises encounter distinct obstacles, such as insufficient capital, which hinder their expansion and profitability, consequently limiting their impact on sustainable development as a result, only a small number of enterprises manage to progress from being micro to medium-scale (Kidali, 2020).

According to the study's findings, growth-oriented small businesses have the greatest impact on job creation and economic expansion during this transitional period. Debt finance refers to the practice of borrowing money with the intention of repaying it, with or without interest. Commercial finance firms, hire purchase agreements, share capital, funds from SACCOs and credit unions, personal networks like friends, family, and welfare groups, supplier credit, and leasing arrangements are some of the ways that businesses can acquire debt financing (Yazdanfar & Öhman, 2015; Tariq, 2013). Other options include asset-based lenders, trade credit, equipment suppliers, insurance entities, bonds, private placements, SBICs, SBLCs, stock trading firms, and private financing.

Venture capital firms are another option for equity funding, among the ones already listed (Tykvová, 2018). Bonini and Capizzi (2019) state that a company's size and stage of development impact its financial requirements, which in turn define the likely sources of financing. Equity finance holds significance for emerging enterprises with high growth potential and inherent risk. Management often favors equity financing over debt financing due to its non-binding nature.

In their annual report on small and medium-sized organizations (2023), the European Commission voiced their concern about the significant decline in lending to these businesses by big financial institutions, which is limiting their growth and financial performance. Due to inadequate or nonexistent retained earnings, Eniola and Entebang

(2015) emphasized debt finance as the principal Ms by which new firms acquire funding. Chakroun et al. (2019) provided evidence that smaller, less liquid organizations have challenges when trying to receive funds from debt markets. However, they were able to secure external financing through linked companies, bank loans, trade credit, and other alternative methods.

Using the POT, Rajamani (2021) examined how loan financing affected the performance of SMEs in India. The purpose of this research was to use panel data analysis to look at how debt affects the performance of SMEs using three financial measures: GPM, ROA, and ROE. The sample included 164 non-financial SMEs from India that were listed on the BSE-SME platform between 2014 and 2018. The research found that SMEs in India are less efficient when it comes to capital structure, especially when it comes to short- and long-term loans.

Debt financing's effect on business performance was the subject of a comparable study in Nigeria by Orji and Agubata (2021). The study collected data from 26 firms, totaling 208 observations, ranging from 2013 to 2020, using the Agency Cost Theory as the underlying framework. Variables such as PSF, LTDF, and STDF (SDF) were used to analyze debt financing, while ROE was used to measure firm performance. We used an OLS Regression Model to statistically examine the parameter estimations, and we developed three hypotheses to guide the investigation. This analysis used an Ex Post Facto methodology and drew its data from the NSE Factbook, as well as the Annual Reports and Accounts. At the 5% level of significance, the study found that debt financing had a favorable and statistically significant effect on firm performance in Nigeria.

A study conducted by Manyanga et al. (2023) applied the capital structure theory to the study of SMEs in Zimbabwe. The objective was to determine the effects of various forms of loan financing on their financial performance. Using a cross-sectional survey approach, the research was grounded on positivism. Through the use of a standardized questionnaire

with Likert-type replies, quantitative data was gathered from 210 SMEs. Debt finance, including both long-term and short-term loans as well as trade credit, improves financial performance in developing economies, according to the findings. Also in the same line, Badi and Ishengoma (2021) looked at the effects of loan financing on the efficiency of Tanzanian SMEs. The study collected data from SMEs who were using the PASS program to access credit from formal financial institutions. The data was analyzed using the capital structure theory. A positive correlation between SMEs' performance and their access to debt financing was found in the data collected from 152 participants. According to the results, a key factor in increasing SMEs' profitability is having access to loan financing.

Kiprotich (2022) utilized the trade-off theory, stewardship theory, and POT to investigate how STDF affected the financial performance of SMEs in Bomet County, Kenya. We used a descriptive research strategy to sift through data from 75 SMEs. For five years (2017–2021), we collected secondary data on the performance, overdrafts, lease financing, and trade credit of SMEs. The presence or absence of autocorrelation, multicollinearity, and normalcy was determined by diagnostic tests. With an R-value of 0.784, the summary of the regression model showed that the predictor variables were highly correlated with the dependent variable. It also emphasizes how the chosen predictors are crucial to understanding the outcome. It also shows how much the predictor factors help explain variances in financial performance, with an R-squared value of 0.614. Lease financing, overdrafts, short-term loans, and trade credit are the variables that, empirically speaking, account for 61.4% of the variance in financial performance.

### **2.3.3 Retained Earnings and Performance of SMEs**

Adjustments from previous quarters (such as mistake corrections), changes in accounting principles, adjustments owing to quasi reorganizations, and undistributed net income make up retained earnings. While retained earnings are generally the go-to for small firms

in most countries when it comes to financing, some companies may have a greater debt-to-equity ratio due to their difficulty in generating retained earnings (Chepkemoi, 2013).

In developing economies without established capital markets, Hermelo and Vassolo (2007) found that emerging businesses often use retained revenues to finance new projects. On the other hand, the report points out that startups may encounter financial limitations and find it difficult to finance development initiatives entirely from retained earnings. This is because their original investments have not yet generated returns or because their investment projects exceed current earnings significantly.

From 2011 to 2015, Yapa Abeywardhana (2016) studied small and medium-sized manufacturing firms in the United Kingdom to determine the impact of capital structure on company performance. The research team used multiple regression and Pearson correlation to draw their conclusions. Firm performance indicators including ROA and ROCE correlate negatively with leverage, according to the research. In addition, a large positive association exists between company size and performance, and a robust negative link exists between liquidity and firm performance. Successful businesses, according to the research, use retained earnings to fund their operations rather than taking on debt. It is especially challenging for SMEs to borrow money and gain access to external financing.

Using a case study approach, Khan, Lamrani, and Khalid (2019) investigated the relationship between business growth and retained earnings behavior with respect to Indian firms. The research covered the years 2014–2018 and looked at a random sample of 149 of the most successful companies. The results showed that rather than taking out loans, moderately expanding businesses mainly used equity capital and retained earnings to fund their fixed assets and capital needs. The study also showed that dividends, cash flow, and external capital all have a big impact on retained earnings, whereas interest payments typically don't make much of a dent. Among low-growth enterprises, cash flow,

dividends, and external sources of funding were found to be important factors affecting retained earnings. The study found a negative correlation between retained earnings and investments in fixed assets and inventory, which could mean that these needs were funded from outside sources and that retained earnings were used to cover the difference. The research concluded that dividends and cash flow are two important factors that affect retained earnings. This study sought out data from profitable organizations by looking at how debt financing relates to retained earnings.

The financial performance and funding structure of supermarkets in Trans Nzoia County, Kenya were studied by Lokwang, Gichure, and Oteki (2018). This study used a questionnaire-based explanatory research approach, drawing from the POT and the Trade-off Theory. A total of 137 participants were surveyed for the study. Analyses were conducted on quantitative data using both descriptive and inferential statistics. Supermarket performance is influenced by retained profits, which are reinvested, according to the results, which showed a strong correlation between the two.

According to research by Sang (2021), microenterprises in Kenya were able to flourish thanks to a savings mobilization approach that encouraged entrepreneurs to put off spending for a while and put money away. The study found that these savings add up over time and are used as retained earnings. They are either reinvested or used for refinancing. Research by Abayo and Oloko (2017) found that most Kenyan microenterprises use retained earnings to buy new equipment over time. Although retained revenues and other internal finance sources are used by many small-scale enterprises in Kenya, Akinyi (2014) warned that this dependence could limit their expansion and negatively affect their financial performance.

#### **2.3.4 Financial Literacy and Performance of SMEs**

The ability to manage one's own financial resources, especially one's own money, with confidence and competence is known as financial literacy (Hennart, 2010). Following this

line of thinking, Barney (2001) defines it as the capacity of a company to create value using its financial assets. Success in this area is related to a company's capacity to make money and build assets; this is dependent on how well the business uses its monetary and non-monetary assets to achieve its objectives. An organization's ability to maximize resource usage, create value, and accomplish strategic objectives depends on the financial judgments made by its members, which in turn depends on their level of financial literacy. Menike (2018) looked at the relationship between financial literacy and the success of Sri Lankan SMEs. All throughout the nation, 378 people filled out questionnaires for a survey. In this study, we looked at how the financial literacy of SMBs affected their company's performance. This included their financial behavior, impact, attitude, and knowledge. There is a favorable correlation between firm performance and financial knowledge, influence, and behavior, but no such correlation between financial attitudes and SME performance, according to the results. The study also shows that SME owners have a good grasp of the parts that make up financial statements and that they draw on their own knowledge as well as that passed down from parents and other family members when it comes to record-keeping procedures.

Yakob et al. (2021) set out to examine the relationship between financial literacy and the success of Malaysian SMEs. An organized questionnaire was used to collect data from 200 managers/owners of SMEs for the study. To determine if financial literacy has an effect on SME performance, we used multiple regression analysis to account for management profile and SME-specific variables. Multiple regression research proved that SMEs' performance is positively and significantly impacted by financial literacy. Businesses benefit from managers and owners who are financially literate because they are better able to handle issues like debt, savings, insurance, and investment plans. Better results for their companies are guaranteed by this grasp of financial principles. Buchdadi, Sholeha, and Ahmad (2020) investigated the effects of financial literacy on the efficiency

and productivity of Indonesian SMEs. In their investigation, they used financial risk mindset and access to financial products as mediating variables. The research analysed the data using SEM, a quantitative approach. Researchers in Central Java's Brebes district surveyed 70 business owners and managers of SMEs. Results showed that a positive attitude toward financial risk, availability to capital, and financial literacy all contributed to the success of SMEs. The study also discovered that financial risk mindset and access to financing mediated the association between financial literacy and the performance of SMEs. Furthermore, financial literacy affected the performance of SMEs in two ways: first, by influencing the availability of financial products; and second, by shaping the perspective on financial risks.

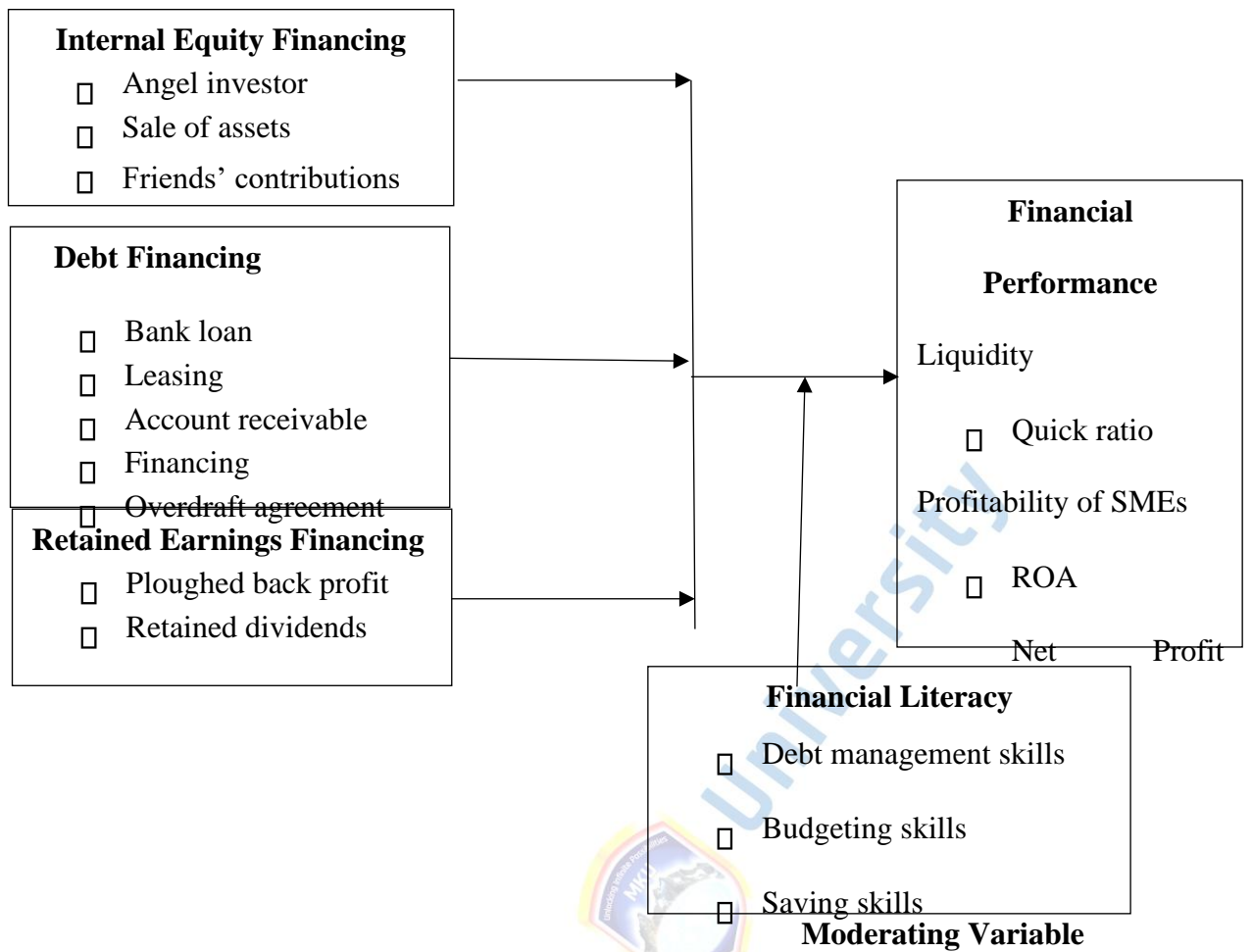
The link between financial literacy and the financial performance of SMEs in the Ntungamo Municipality of Uganda was the subject of a comparable study by Arinda (2019). Based on the research's theoretical foundations in Goal Setting Theory and Prospect Theory, 97 respondents were chosen at random from a pool of 130 SMEs in the Ntungamo Municipality area. The survey was conducted using a standardized, self-administered questionnaire. Research shows that SMEs' financial performance is significantly and statistically predicted by their level of bookkeeping literacy (Adjusted  $R^2=0.077$ , P-value = 0.015) and debt management literacy (Adjusted  $R^2= 0.096$ , P-value = 0.007). A positive but statistically insignificant effect of budgeting literacy on financial performance was observed ( $p=0.169$ ), above the significance level of 5%. At the 5% level of significance, the study found that financial literacy has a favorable effect on financial success ( $p\text{-value}= 0.025$ , Adjusted R square= 0.116). Findings suggest that financial literacy has a substantial effect on SMEs' bottom lines.

Equity Bank taught women's self-help groups in Machakos County how to handle their money, and Mberia (2023) looked into how that training affected their financial performance. The study acknowledged how important knowing about money is for doing well with money. Based on Bruce Tuckman's Theory of Group Development and

Expectancy Theory, the study looked at 33 female self-help group leaders who had been trained by Equity Bank. This study used a census method to collect data, which was done with a questionnaire. When Equity Bank taught women's self-help groups in Machakos County four important things about money, they did better financially: planning, saving, managing debt, and using banking goods and services. These self-help groups did better with their money after getting training in these areas of financial knowledge.

#### **2.4 Conceptual Framework**

Following a survey of the pertinent literature, Figure 1 displays the study's conceptual model. An illustration of the hypothesised relationship between the study's independent and dependent variables can be seen in the conceptual model. The uwezo fund-funded SMEs' financial performance is used as the dependent variable, with financial literacy, internal equity financing, retained earnings, and loan financing as the independent variables. Level of education will serve as the moderating variable in this investigation. Some believe that one's degree of education is a determinant of the efficacy with which the independent variables affected the financial performance of micro enterprises. This is because, for example, an individual lacking in education might not know when to ask for more money and from where to get it. However, in this study but in this study these variables were been held at a constant or at zero Ming they did not have an effect on the dependent variable.



**Figure 1: Conceptual Framework**

**Source: Researcher (2024)**

## CHAPTER THREE

### RESEARCH METHODOLOGY

#### 3.1 Introduction

In this section, the procedures that will be followed to complete the research are detailed. Included are details regarding the research plan, target demographic, sampling strategy, sample size, and sampling frame. In addition, it specifies the research instrument's validity and reliability evaluation, data collection procedures, and preliminary testing, data processing, and presentation methods.

#### 3.2 Research Design

Research plans, which are also known as strategies for inquiry, are specific ways of doing research in the qualitative, quantitative, and mixed methods research models. They spell out the steps that need to be taken to complete a study (Indu and Vidhu Kumar, 2019). Njeru (2013) says that one of the main goals of a research plan is to make sure that the evidence is gathered in a way that answers the research questions in a clear way. The study plan can make many research tasks easier when it's done right, so that the most information can be gathered with the least amount of time, effort, and money (Mugenda, 2008). The study used a descriptive research approach that included ways to define factors and methods for doing so. The most important things will be collecting data that sheds light on events and then organizing, tabulating, showing, and describing that data. Describe studies answer the "who," "what," and "how" questions by giving a picture of the factors (Babbie, 2009).

Since written questionnaires were used to gather data, a descriptive approach seemed appropriate for this investigation. Researchers can better define, document, analyze, and report current or historical conditions when they choose a descriptive approach, as Yin (2013) argues. To answer the research questions, provide information on the current state of the event, and depict "what exists" in relation to a specific condition or variable in a

given context, this research approach is suitable. It is also possible to incorporate both qualitative and quantitative methods of data collection into the design, which allows for the observation of the phenomenon under study in its natural and unaltered environment.

### 3.3 Location of the Study

This study's data came from Meru County, one of forty-seven (47) counties created under the Kenyan Constitution (2010). In the north, Meru County meets Isiolo County; in the south, it meets Tharaka-Nithi County; in the southwest, it meets Nyeri County; and in the west, it meets Laikipia County. The population of the county is 1.35 million, and there are nine (9) constituencies (KNBS, 2019). The primary economic activity of the county is agriculture.

### 3.4 Target Population

Research conclusions are based on the entire set of units that make up the target population, which is defined as the set of units to which the study's findings are most broadly applicable (Casteel & Bridier, 2021). Included in this category are all parts that meet the specific requirements set out for a study. According to Crespo et al. (2021), it encompasses the entire group of people or things that share certain characteristics determined by the study's sampling criteria. The 1,859 small and medium firms located in Meru County that have been funded by the Uwezo Fund were the intended subjects of this study (Uwezo Fund Oversight board records Meru County, 2022).

In Table 1 we can see the breakdown of the number of SMEs by constituency..

**Table 1: Target Population**

Constituency	Target Population	Percent
Buuri	184	9.9
Igembe North	210	11.3
Igembe Central	215	11.6
Igembe South	177	9.5
	35	

North Imenti	235	12.6
South Imenti	230	13.4
Central Imenti	221	11.9
Tigania East	198	10.7
Tigania West	189	9.1
<b>TOTAL</b>	<b>1859</b>	<b>100</b>

Source: Uwezo Fund Oversight Board Records Meru County (2022)

### 3.5 Sample and Sampling Techniques

Obtaining a representative sample is essential in research, as it requires balancing confidence and precision (Saunders et al., 2009). This is particularly true when increasing the sample size is not possible, for example, because of financial limitations. Accuracy, confidence, and population variability in the measured variables should all be considered when deciding on an appropriate sample size. To determine the appropriate sample size of 329, this study will employ the formula proposed by Singh and Masuku (2014), which is derived from Yamane's (1967) thesis.

$$n = \frac{N}{1 + N(N - 1)e^2}$$

Where;

where  $e$  is the degree of precision,  $N$  is the population size, and  $n$  is the sample size. Since a 95% precision level is used to improve sample estimate accuracy, the population size is 1859 and the value of  $e$  is 0.05..

Sample calculation

$$n = \frac{1859}{1 + 1859(1859 - 1)0.05^2}$$

$$= 329$$

$n=329$

The calculated sample size, based on Slovin's Formula, is 329 responses, or 17.7% of the entire targeted population. Choosing a sample from a sampling frame is crucial, according to Ragab and Arisha (2018). The sample for this investigation was selected from a frame that included 1,859 SMEs located in Meru County that had been funded by the Uwezo Fund. Stratified random sampling, which is a sampling methodology that divides a population into discrete subgroups, or strata, that share comparable features, was the approach used to choose the sample. Making sure that every subgroup is fairly represented in the sample as a whole is the goal. This method was used in the study to choose the sample, and 329 respondents were chosen from each strata. According to Dubey and Kothari (2022), a representative sample is one that represents roughly 10– 50% of the population being studied. The owners of these SMEs, who were recognized in their places of operation, were the respondents chosen for this study.

**Table 2: Sample Size**

Constituency	Target Population	Proportions	Sample size
Buuri	184	9.9	33
Igembe North	210	11.3	37
Igembe Central	215	11.6	38
Igembe South	177	9.5	31
North Imenti	235	12.6	41
South Imenti	230	13.4	44
Central Imenti	221	11.9	39
Tigania East	198	10.7	35
Tigania West	189	9.1	31
<b>TOTAL</b>	<b>1859</b>	<b>100</b>	<b>329</b>

**Source: Researcher (2024)**

### **3.6 Data Collection Instruments**

Xuan, Williams, and Peat (2020) say that data collection devices are the things that are used to get information from the people who are picked to be part of the study. Questionnaires will be used to get first-hand information for this project. There are both organized and open questions in the form. Díaz (2019) says that surveys are used to gather information because they are simple to use, score, and look at the results of. In addition, secondary data from reputable and well-known sources that includes study-relevant parts. The owners of the SMEs' written financial records were the ones who gave this information. The study was mostly collecting secondary data about things like more sales, higher earnings, bigger workforces, and happy customers..

### **3.7 Pilot Study**

A preliminary evaluation was done on the research tool before the real probe to make it better and easier for people to use. This process was also used to make sure that the data received was correct and that the study tool was correct. Using the data from the pilot test, the researcher did a basic review to make sure that the collected data could meet the study's goals (Saunders, Lewis, & Thorn Hill, 2012). Kothari (2009) said that the pretest sample proportion should be 5 to 10 percent of the main study's sample size, taking into account things like cost, time, and usefulness. People who took part in the preliminary evaluation were not included in the main study. As part of the pilot evaluation for this study, 32 surveys were sent to small business owners in Tharaka Nithi County's Maara district who had gotten funding from the Uwezo fund. The evaluation was done on a 10% scale.

### **3.8 Testing for Validity and Reliability**

#### **3.8.1 Validity**

The legitimacy of a study tool is based on how well it measures the things it's meant to measure (Taherdoost, 2016). It looks at how well the tool tracks the factors it's supposed

to measure and how the data is shown in relation to a certain concept (Taherdoost, 2016). Face validity, topic validity, and construct validity were the major things that were looked at during the validation process. Face validity is how someone thinks about whether or not a test or measure seems to be measuring what it's meant to measure. If a measure correctly measures the theoretical construct or trait that it is meant to test, that is called construct validity. On the other hand, if a measure sufficiently and representatively samples the topic or content area of interest, that is called content validity. To make the poll more reliable, the scholar talked to the Strategic Management Faculty and other experts. A thorough review of the theory and empirical literature on the study factors made sure that the instrument was construct valid and had valid content. The study tool was more valid after this thorough evaluation process, which allowed it to be improved and changed.

### **3.8.2 Reliability**

Reliability is defined by Saunders et al. (2009) as the degree to which a study's methods for gathering data or analyzing it produce consistent results at different times and by different observers, as well as if the data that is derived from raw data is transparent. Biases or mistakes made by participants or observers are examples of potential risks to reliability. These risks were reduced by using a methodical data gathering instrument that was used in a short amount of time. It is essential to report the Cronbach's alpha coefficient when employing Likert-type scales since it evaluates the internal consistency reliability, or how consistent an instrument's items are with each other and with the instrument as a whole (Croasmun & Ostrom, 2011). Cronbach's alpha calculates the relationship between each item and the entire instrument in order to determine internal consistency.

Using Cronbach's alpha, which was first proposed by Cronbach in 1951, the reliability of the Likert-type scale items in the data collecting tool was assessed in this study. Higher

internal consistency is indicated by Cronbach's alpha values that are closer to 1. Variable measures in this study must have Cronbach's alpha values greater than 0.7 in order to be deemed reliable.

### **3.9 Data Collection Procedure**

The NACOSTI granted additional approval for the research after the university gave its consent. Through the Uwezo Fund Constituency offices, the researcher individually distributed questionnaires to the participants. Because of the large geographic area from which the data was gathered, the respondents were then allowed a week to answer to the questionnaires. The researcher then conducted follow-ups and, with the assistance of research assistants, selected the fully completed questionnaires from the respondents. One benefit of using questionnaires to gather data was that the researcher could personally present the study to the participants, explain its purpose, and answer any questions or concerns they might have had.

### **3.10 Data Analysis and Presentation**

The particular goals stated and the selected research strategy served as a guide for the data analysis in this study. The data that was gathered was analyzed using the Statistical SPSS. The questionnaires were grouped according to variables, coded, and referenced in order to make data entry into the software easier. Using descriptive and inferential statistical methods, the analysis mostly concentrated on quantitative and qualitative data.

Descriptive statistics enable researchers to quantitatively characterize and compare variables based on two essential parameters: dispersion and central tendency (Saunders et al., 2009). The M, median, and mode are the three indicators of central tendency. Both the difference within the middle 50% of values (interquartile range) and the degree to which values depart from the M (SD) can be used to evaluate measures of dispersion, which show how data values are distributed around the central tendency. The results of descriptive statistics displayed as figures and tables.

Researchers can compare the gathered data with theoretical expectations by using inferential statistics to see whether correlations exist among the variables being studied. Inferential statistics, also referred to as significance testing, aid in eliminating the idea that the observed results could be the product of random fluctuation in the sample, as explained by Saunders et al. (2009). Additionally, using the sample data to estimate population parameters is made easier by inferential statistics. ANOVA is used in inferential statistics. Additionally, the financial performance of SMEs was regressed against retained earnings, debt financing, internal equity financing, and financial literacy in order to undertake multiple regression analysis. Based on the variables thought to influence SMEs' financial performance, the study created a financial performance model. As a result, the study used each variable's linear regression results, as described below:

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon$$

Where;

Y= Performance of SMEs  $\beta_0$ =

Constant (coefficient of intercept),

$X_1$ = Internal Equity Financing

$X_2$ = Debt Financing

$X_3$ = Retained Earnings

$X_4$ = Financial Literacy  $\varepsilon$

= error term.

### **3.11 Ethical Considerations**

An introduction letter and ethical approval were acquired from Mount Kenya University's postgraduate directorate prior to the start of data collection. A study authorization was also obtained from NACOSTI. Respondents were not under any kind of duress and were allowed to give information voluntarily. Additionally, they were told that they could leave the research at any time if it made them uncomfortable. The researcher emphasized the

confidentiality and privacy of the data, ensuring respondents that their information would be treated with the utmost discretion. This assurance encouraged honest and consistent data provision, as respondents were to feel confident in their anonymity and understand the study's primary objective. It was stored in the university database to safeguard the collected data, accessible only to authorized personnel.

## **CHAPTER FOUR**

### **RESEARCH FINDINGS AND DISCUSSIONS**

#### **4.1 Introduction**

In this part, the result is looked at and explained. The study's goal was to find out how the capital structure of small businesses in Meru County, Kenya, that got help from the Uwezo Fund affected how well they did financially. This chapter gives the study's results and some comments based on the factors used in the study. This part gives information about the people who answered the survey, what the study looked like, how it was done, and how the results relate to the theory and empirical review.

#### **4.2. Response Rate**

The researcher distributed 329 questionnaires to the sampled respondents but picked 291 questionnaires, which were fully responded to as presented in table 3.

**Table 3: Response rate**

		<b>Frequency</b>	<b>Percent</b>
<b>Valid</b>	Response	291	88.4
	Non – Response	38	11.6
	Total	329	100.0

Source: Researcher (2024)

Because the researcher self-administered the questions and gave respondents a high level of secrecy, the response rate was 88.4%. A response rate of 50% is deemed satisfactory,

60% is good, and 70% is exceptional, per Mugenda & Mugenda (2003). As a result, the response rate was regarded as exceptional and trustworthy.

### 4.3 Results of the Pretesting of Research Instrument

The study's goal was to find out how reliable the research tools were. Table 4 shows the findings.

**Table 4: Cronbach Alpha for Reliability Assessments**

Variables	Cronbach Alpha values	Remarks
Equity financing	0.795	Reliable
Debt financing	0.776	Reliable
Retained earning	0.802	Reliable
Financial literacy	0.786	Reliable
Financial performance	0.817	Reliable

Source: Researcher (2024)

The Cronbach alpha coefficient results for the various items were between 0.772 and 0.817, as seen in Table 4. As a result, the instrument achieved the suggested criterion of a value greater than 0.7.

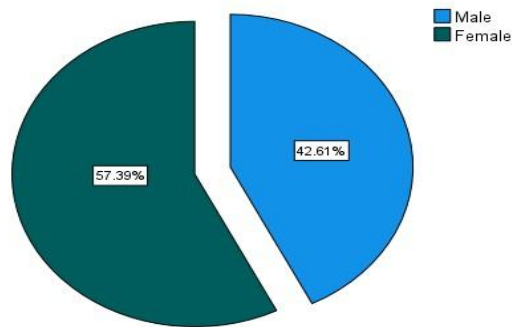
### 4.4 Demographic Characteristics

Based on the respondents' gender, age, position, and educational attainment, the study aimed to determine the background characteristics of the SMEs and respondents.

#### 4.4.1 Gender of the Respondents

The study sought to establish the gender composition of the respondents in Meru County.

tick against the answer of your choice

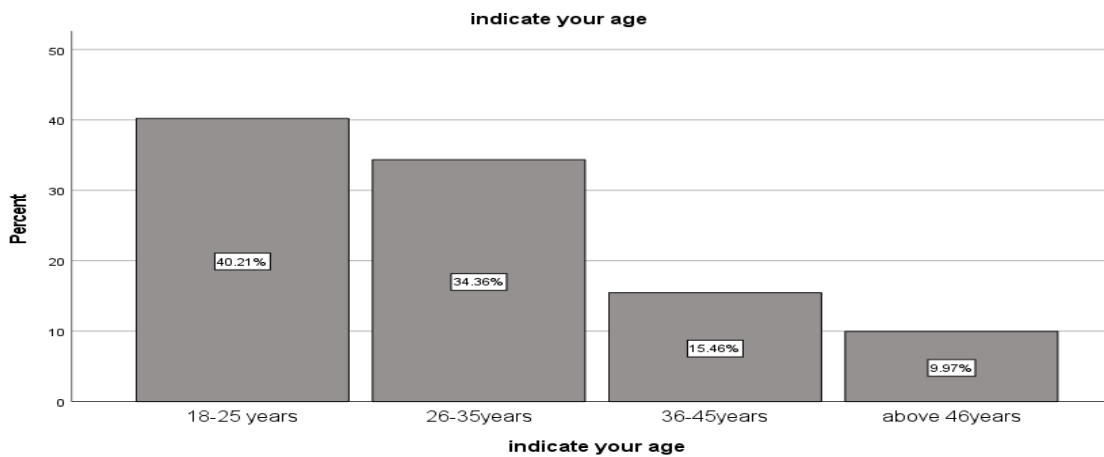


**Figure 2: Gender of the Respondents**

Figure 2's findings revealed that 27% of respondents were men and 73% of respondents were women. This showed that, in comparison to their male counterparts, a greater number of enterprises were run and managed by female entrepreneurs.

#### 4.4.2 Age of the respondents

The study sought to determine the age composition of the respondents.



**Figure 3: Age of the respondents**

Source: Researcher (2024)

Figure 3's findings showed that the largest percentage of respondents (40.21%) were in the 18–25 age range. Additionally, it was observed that 15.46% of respondents were beyond the age of 36 to 45, while 34.36% of respondents were between the ages of 26

and 35.99%, however, were older than 46. This recognized that a large number of entrepreneurs are in the youngest entrepreneurs' age range. This was ascribed to the government's Uwezo Fund job empowerment project for youth.

#### 4.4.3 Position Held by the Respondent

The study sought to establish the position held by the respondents.



**Figure 4: Position Held by Respondents**

Source: Researcher (2024)

Figure 4's findings showed that 22.34% of respondents were both firm owners and managers, whereas 38.83% of respondents were both managers and owners. This showed that 38.83% of respondents were employed to manage firms, but the majority of SMEs in Meru County that received funding from the Uwezo fund were run by owners.

#### 4.4.4 Education Background

The study sought to determine the education level of the respondents.

**Table 5: Education Level of the Respondents**

		Frequency	Percent
<b>Valid</b>	Primary Certificate	33	11.3
	Secondary Certificate	58	19.9

Diploma	102	35.1
Undergraduate	93	32.0
Postgraduate	5	1.7
Total	291	100.0

Source: Researcher (2024)

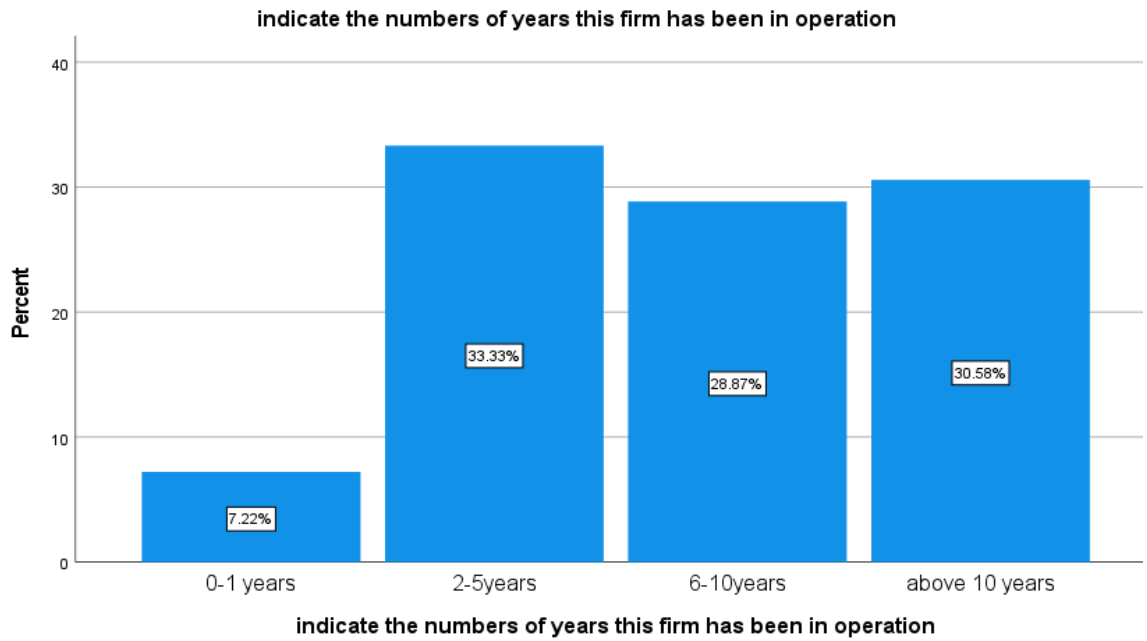
The table's data show that the sample's educational backgrounds are varied, with the bulk of respondents—35.2%—having a diploma as their greatest academic achievement. Of those surveyed, 32.0% held a bachelor's degree. 19.9% of respondents said their greatest academic accomplishment was a secondary certificate. The study also found that only 1.7% of respondents had completed postgraduate education, and 11.3% of respondents had merely a primary certificate as their highest academic credential. This emphasizes how companies are run by the affluent segment of society that comprehended the inquiries.

#### **4.5 Firm Characteristics**

Identifying firm characteristics, including length of operation, business kind, legal status, number of workers, capital size, and annual sales volume, was another goal of the study..

##### **4.5.1 Period of Firm Existence**

The study sought to establish how long has the business been in existence.



**Figure 5: Period of Firm Existence**

Source: Researcher (2024)

According to the study's findings, which are shown in Figure 5, the majority of enterprises (33.3%) have been in operation for two to five years, while 28.87% have been in operation for six to ten years. 7.22% of businesses have been in operation for less than a year, and 30.58% have been in operation for more than ten years. This shows that 59.44% of business units have surpassed the infancy stage of growth, while 40.55% of firms are still in the early phases of development.

#### 4.5.2 Category of the Business

The study sought to identify in which category the business units belonged to.

**Table 6: Category of the Business**

		Frequency	Percent
<b>Valid</b>	Service	97137	47.1
	Manufacturing	57	19.6
	Trade	97	33.3
	Total	291	100.0

Source: Researcher (2024)

According to the data in the table, 47.1% of SMEs are in the service industry, which includes establishments like hotels, spas, cyber cafés, and security companies. In contrast, 33.3% work in trade sectors such as supermarkets, hardware stores, general stores, and bookshops. Companies that produce yogurt and water make up the majority of the manufacturing sector, which accounts for 19.6% of the total. According to this statistics, a large number of Meru County business owners would rather invest in the service industry than manufacturing.

#### 4.5.3 Legal Status of the Business

The research study sought to determine the legal status of the businesses.

**Table 7: Legal Status of the Business**

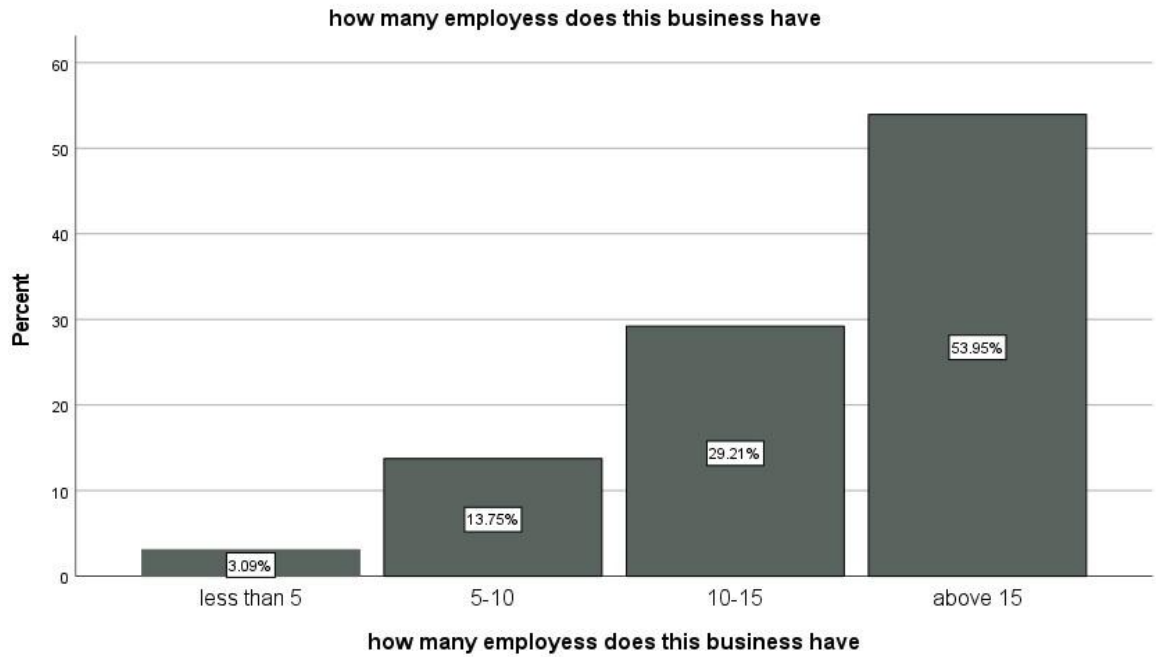
		Frequency	Percent
<b>Valid</b>	Sole Proprietor	69	23.7
	Partnership	132	45.4
	Limited Company	90	30.9
	Total	291	100.0

Source: Researcher (2024)

According to the data in Table 7, 45.4% of SMEs were partnerships, 30.9% were limited companies, and 23.7% were single proprietorships. The simplicity of the UWEZO fund's capital requirements and regulatory procedures upon inception may be largely responsible for this.

#### 4.5.4 Number of Employees

The study sought to determine the number of employees on engagement.



**Figure 6: Number of Employees**

Source: researcher (2024)

Results from Figure 6 established that the firms with more than 15 employees represented 53.95% of the respondents, those with 10 – 15 employees were 29.21% and 13.7% of the SMEs had 5 – 10 employees while those with less than 5 employees. This outcome was due to the fact that most businesses were partnership and limited companies.

#### 4.5.5 Capital Size of the Firm

The study sought to establish the capital size of the firm.

**Table 8: Capital Size of the Firm**

		Frequency	Percent
<b>Valid</b>	Less Than 0.5million	35	12.0
	0.5-1 million	131	45.0
	1-1.5 million	70	24.1
	Above1.5million	55	18.9
	Total	291	100.0

Source: Researcher (2024)

According to the data, 45.5% of business enterprises operate with a capital basis of between 0.5 million and 1.0 million shillings. This implies that a large number of companies are either still in their infancy or very small. A modest level of investment is shown by the fact that 24.1% of enterprises have assets worth between 1.0 and 1.5 million shillings. However, 18.9% of businesses said they had assets worth more than 1.5 million shillings, which can be a reflection of larger or more established businesses in the market. Last but not least, the 12.0% of companies with capital under 0.5 million shillings indicates a smaller group of organizations that would have more difficulties growing and obtaining resources.

#### 4.5.6 Firms Annual Sales Turnover

The study sought to determine the annual sale turnover of the businesses within Embu town.

**Table 9: Firms Annual Sales Turnover**

		<b>Frequency</b>	<b>Percent</b>
<b>Valid</b>	Less than 0.5million	67	23.0
	0.5-1million	113	38.8
	1-1.5million	88	30.2
	Above 1.5million	23	7.9
	Total	291	100.0

Source: Researcher (2024)

The results give an intriguing summary of the respondents' sales turnover. A sizable percentage, 38.8%, stated that their yearly sales turnover was between 0.5 million and 1 million shillings. This suggests that many firms are functioning in this mid-range, which could be a sign of stability or a typical entrance point for enterprises. On the other hand, a sizable portion of businesses that are expanding moderately are shown by the 30.2% of businesses that recorded sales between one million and 1.5 million shillings. This can

indicate successful company plans or favorable market circumstances for this market niche.

23.0% of businesses reported yearly revenues of less than 0.5 million shillings, which is at the lower end of the scale. Given that these companies are running at comparatively low turnover rates, this number may cast doubt on their ability to continue operating or make growth-oriented investments. Lastly, a smaller but significant portion of highperforming companies is represented by the 7.9% of businesses that record sales of more than 1.5 million shillings. Given their potential to greatly increase employment and innovation, this group may be essential to economic growth.

#### 4.6 Descriptive Statistics

In addition to discussing the capital structure and financial performance of SMEs in Meru County that were sponsored by the Uwezo fund, this part offers an analysis of the descriptive data. Measures of central tendency and SD are used to present the findings.

The five-point Likert scale is used to make the interpretations: 5 "strongly agree," 4 "agree," 3 "not sure," 2 "disagree," and 1 "strongly disagree."

##### 4.6.1 Equity Finance and Financial Performance

The primary goal of this research was to look at how the Uwezo fund in Meru County, Kenya, affected the bottom lines of SMEs that had taken out equity financing internally.

Table 10 shows the M and SD of the replies to a series of equity finance questions.

**Table 10: Descriptive Statistic on Equity Financing**

	N	Min	Max	M	SD
Businesses often use their ploughed-back profits to refinance their debt.	291	1.00	5.00	3.75	0.961
Profits that are kept by the business help it grow in the long run.	291	1.00	5.00	3.49	1.001
Angel backers give this company most of its money.	291	1.00	5.00	2.86	0.807
Funding for the business comes from gifts from friends.	291	1.00	5.00	4.51	0.838

---

Source: Researcher (2024)

Table 10's findings show that respondents agreed with the majority of the equity financing constructs, particularly that they finance their enterprises using plowed back profit (M=3.75, SD=0.961). Participants' perception that the company depends on reinvested profits for refinancing is demonstrated by this. Although the majority of respondents agree with this statement, there appears to be some variation in viewpoints, as indicated by the SD of 0.961, which indicates a moderate level of agreement among respondents. Additional respondents (M=3.49, SD=1.001) expressed no view regarding their retention of profit for long-term growth. A larger range of responses is indicated by a SD of 1.001, which suggests that views on the function of retained earnings may differ greatly. Over angel investors as a significant source of business finance, respondents were undecided (M=2.86, SD=0.807) over their importance in supplying capital. The very low SD of 0.807 indicates that respondents generally agreed that angel investors might not be very important in funding the company. Participants did, however, strongly agree with the statement regarding friends' contributions to business financing (M=4.51, SD=0.838), suggesting that respondents view friend contributions as an essential source of funding for the company. There is reasonable agreement on this viewpoint, as indicated by the SD of 0.838, which suggests that participant answer variances are minimal. Information from the SMEs' status, where the majority of the enterprises were partnerships, can be used to support this claim.

The results support those of Nguyen, Le, and Vo (2023), who claim that small business owners strongly favor finance methods that involve little to no interference with their operations. Many small firms start out as family businesses, which may not focus on company expansion tactics but instead place a higher importance on relationships and

connections than on material wealth. Tenca, Croce, and Ughetto (2019) found that business angels were the most sought-after and coveted source of funding for German businesses. This was because, by offering start-up money, they actively participate in the early phases of business development. Due to their opaqueness, SMEs can be difficult for outside investors to adopt and manage. These make it difficult for prospective investors to evaluate the business and decide whether to invest in it. This was demonstrated by the firm preference for employing friend contributions and reinvesting profits to operate the company instead of hiring angel investors.

#### 4.6.2 Debt Financing and Financial Performance

The study's second goal was to ascertain how loan financing affected the financial performance of SMEs in Meru County, Kenya, that were supported by the Uwezo fund. As shown in Table 11, a set of debt financing items were used, and the responses are displayed in M and SD.

**Table 11: Descriptive Statistic on Debt Financing**

	N	Min	Max	M	SD
Trade credit is applied the financing the firm	291	1.00	5.00	3.66	1.087
Use of differed income to increase working capital	291	1.00	5.00	3.59	0.996
Overdraft agreement affects the way business operates	291	1.00	5.00	4.34	1.065
The firm used accrued expenses to finance its operations	291	1.00	5.00	3.89	0.853
The firm lease agreement to acquire asset	291	1.00	5.00	2.86	0.983
The firm used factoring to finance its operations	291	1.00	5.00	2.43	1.020
Use of bank loans has been increasing overtime	291	1.00	5.00	3.78	0.930
Valid N (listwise)	291				

Source: Researcher (2024)

Table 11's study results showed that respondents agreed with the use of trade credit to finance their businesses ( $M=3.66$ ,  $SD=1.087$ ). Moderate response variability is indicated by the  $SD$  of 1.087. Additionally, respondents agreed that using deferred income to increase working capital was beneficial ( $M=3.59$ ,  $SD=0.996$ ). The low  $SD$  of 0.996 suggests that participants' responses regarding the usefulness of deferred income for working capital were more consistent. Additionally, the majority of respondents strongly agreed that overdraft agreements had an impact on how businesses function ( $M=4.34$ ,  $SD=1.065$ ). This indicates some variance, but it still suggests that most respondents agree. The study also found that respondents ( $M=3.89$ ,  $SD=0.853$ ) agreed that their companies support their operations through accumulated expenses. The low  $SD$  suggests that respondents are highly consistent and in agreement. According to the results, [participants] continued to use the leasing agreement from the company to purchase assets ( $M=2.86$ ,  $SD=0.983$ ). While respondents agreed with the assertion that bank loans are increasingly being used to finance business operations ( $M=3.78$ ,  $SD=0.930$ ), they disagreed with the statement that their companies used factoring to finance their operations ( $M=2.43$ ,  $SD=1.020$ ).

The results support the findings of Gandhi and Nasit (2022) that overdrafts are more advantageous than alternative short-term debt options. Since the overdraft balance is a component of short-term debt, it is usually excluded from estimates of the financial gearing of the company. According to Gerstle (2022), the majority of larger American companies gave their clients additional trade credits during the financial crisis. Businesses that rely heavily on short-term loans eventually pay off their debt. This is because the short-term debt has a one-year maturity date.

The results were in line with those of Demirgüç et al. (2020), who came to the conclusion that large small businesses depend more on long-term debt and outside funding, such as bank loans. SMEs are more dependent on bank loans, according to Andrieu et al. (2018). For SMEs, bank loans yield higher returns than other financing options, despite their higher cost. Businesses that are subject to bank oversight and response over their use of the funds are more likely to use them effectively. In addition to provide much-needed funding to entrepreneurs to launch new ventures or grow already-existing ones, banks also offer a range of services, such as training (Andrieu et al., 2018).

The findings of Eyiah and Bondinuba (2020) were consistent with this, since they discovered that Ghanaian SMEs favored term loans because of their payback schedule, which aligns with their cash flows. The payment date for this kind of loan is therefore set to fall on the time that the company has earned additional funds to cover the loan.

#### 4.5.3 Retained Earnings and Financial Performance

Examining the impact of retained earnings on the financial performance of SMEs in Meru County, Kenya, that receive funding from the Uwezo fund was the third goal of the study. As shown in Table 12, a set of retained earnings questions were employed, and the results are displayed in M and SD.

**Table 12: Descriptive Statistic on Retained Earnings**

	N	Min	Max	M	SD
Retained earnings should be used for owner use since they are profit.	291	1.00	5.00	4.09	0.822
When declaring divided, the retention ratio is not relevant.	291	1.00	5.00	3.33	0.830
Money held in the bank for future use is known as retained earnings.	291	1.00	5.00	3.59	0.905
Retained earnings must be reinvested in order to foster growth.	291	1.00	5.00	3.20	1.050

Reserve amounts are kept at the same level to make sure activities don't stop.	291	1.00	5.00	3.95	0.817
Retained gains are the least expensive way to get money.	291	1.00	5.00	4.05	1.002
Keeping revenue drops the gearing ratio, which makes it less likely that the company will go bankrupt.	291	1.00	5.00	3.03	0.952
When gains aren't enough to spend, it's better to wait than to put out new stocks.	291	1.00	5.00	3.12	0.954
Valid N (listwise)	291				

Source: Researcher (2024)

According to the results shown in Table 12, most respondents (M: 4.09, SD: 0.822) agreed that retained earnings might be used for owner consumption and be regarded as profit. The moderate degree of agreement indicated by the SD of 0.822 suggests that there is considerable variation even if the majority of respondents hold this opinion. This response might be an indication that owners may use retained earnings for personal benefit rather than reinvesting them in the business under specific circumstances. Additionally, respondents expressed a neutral position, slightly disagreeing with the notion that the retention ratio is unimportant when declaring dividends (M=3.33, SD=0.830), while also agreeing that retained earnings could be regarded as profit and used for owner consumption (M: 4.09, SD: 0.822).

The results also showed that respondents agreed with the definition of retained profits, which is money held in the bank for future usage (M=3.59, SD=0.905). Indicating that most participants view retained earnings as money set aside for future use. The neutral but nearly "agree" response, with an M of 3.20, suggests that people share the notion that

retained earnings should be reinvested for future growth. Nonetheless, there appears to be significant variation in the responses, as indicated by the high SD of 1.050. The significance of reserve levels for operating continuity was also acknowledged by respondents (M=3.95, SD=0.817).

With a M score of 4.05 and a SD of 1.002, respondents largely agree that retained profits are the least expensive source of funding. On the other hand, a M of 3.03 with a SD of 0.952 indicates a neutral position with regard to retained earnings' capacity to reduce the gearing ratio. Furthermore, with a SD of 0.954, the M score of 3.12 on the preference for postponing investments when profits are insufficient over issuing additional securities indicates a neutral to modest agreement.

#### 4.6.4 Financial Literacy and Financial Performance

The study's fourth goal was to determine how much financial literacy influences the financial performance of SMEs in Meru County, Kenya, that receive funding from the Uwezo Fund. Table 13 shows the M and SD of the responses to a set of financial literacy questions.

**Table 15: Descriptive Statistic on Financial Literacy**

	N	Min	Max	M	SD
Shorter debt collection periods have a positive effect on financial performance on SMEs	291	1.00	5.00	3.59	0.863
Prequalifying debtors before granting credit has a positive effect on financial performance SMEs	291	1.00	5.00	3.85	0.849
The SME leadership has sales prediction experience and knowledge	291	1.00	5.00	3.34	1.016
We are prudent in our spending and we stress cost reduction	291	1.00	5.00	2.79	1.057

Book keeping expertise has enabled us to file the tax returns without engaging a consultant	291	1.00	5.00	3.04	0.818
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Valid N (listwise) 291

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Source: Researcher (2024)

Table 15's results showed that respondents ( $M=3.59$ ,  $SD=0.863$ ) agreed with the assertion that shorter debt collection periods had a beneficial impact on financial performance. This shows that prompt payments improve cash flow and liquidity, which are essential for the viability of SMEs. A considerable degree of agreement among respondents is shown by the SD of 0.863. Additionally, participants concurred that prequalification of debtors improves financial performance ( $M=3.85$ ,  $SD=0.849$ ), indicating that SMEs should give risk management strategies top priority in order to reduce the financial loss brought on by bad debts.

Regarding the leadership's capacity to forecast sales using knowledge and experience, there had a neutral opinion ( $M=3.34$ ,  $SD=1.016$ ). Additionally, respondents ( $M=2.79$ ,  $SD=1.057$ ) do not agree or disagree with their spending patterns and dedication to cost reduction. This suggests that a large number of respondents would acknowledge that their overall performance may suffer if they don't improve their financial discipline. This difference in opinion is further supported by the SD of 1.057, which shows that different people have different opinions about the way that spending is done nowadays.

Additionally, respondents' opinions on bookkeeping expertise were indifferent ( $M=3.04$ ,  $SD=0.818$ ), suggesting that many SMEs are ambivalent even while some are confident in their capacity to handle their money on their own. The 0.818 SD indicates a respectable degree of consensus among those surveyed.

#### 4.6.5 Financial Performance

The study's independent variable was financial performance, and its goal was to ascertain how well SMEs were doing financially.

**Table 16: Descriptive Statistics on Financial Performance**

	N	Min	Max	M	SD
The most recent level of earnings went up after stock financing was used.	291	1.00	5.00	3.51	1.027
The firm's cash situation affects how well it does.	291	1.00	5.00	4.44	0.502
The high rate of sales rise is because debt financing was used.	291	1.00	5.00	3.71	1.003
The firm's financial success is affected by where its money comes from.	291	1.00	5.00	4.37	0.904
Valid N (listwise)	291				

Source: Researcher (2024)

The results showed that the source of financing ( $M = 4.37$ ,  $SD = 0.994$ ) and the liquidity situation ( $M = 4.44$ ,  $SD = 0.502$ ) significantly affect the financial performance of SMEs, as demonstrated in Table 16. Additionally, respondents concurred that using debt was responsible for the increase in sales ( $M = 3.71$ ,  $SD = 1.327$ ), whilst using equity was responsible for the increase in profits ( $M = 3.51$ ,  $SD = 1.207$ ). These findings suggest that the sources of funding that SMEs use have a significant impact on their financial performance. These companies' increased reliance on debt and equity financing improves their liquidity position and makes it possible for them to pay their debts on time. A liquid

form has enough cash and liquid assets on hand, as well as the capacity to swiftly raise more funds from other sources in order to meet financial commitments and payment obligations as needed. According to Arnold (2008), having cash on hand has several benefits, including the ability to cover daily costs like salaries, taxes, and raw materials; because cash flows are unpredictable, having cash on hand provides a safety margin for potential downturns; and having cash on hand ensures an instant reaction to a highly profitable investment.

#### 4.7 Inferential Statistics

This section gives an analysis of the relationship between dependent and independent variables.

##### 4.7.1 Correlation

Pearson correlation was used to examine the relationship between the study independent variables (Equity financing, Debt financing, retained earnings and financial literacy) and the dependent variable (financial performance) and results are shown on Table 17.

**Table 17: Correlation**

		Equity financing	Debt financing	Retained earnings	Financial literacy	Financial performance
Equity financing	Pearson Correlation	1	.			
	Sig. (2-tailed)					
	N	291				
Debt financing	Pearson Correlation	0.206**	1			
	Sig. (2-tailed)	0.000				

	N		291	291		
Retain earning	Pearson Correlatio n		0.123	.140*	1	.
	Sig. (2- tailed)		0.000	0.017		
	N		291	291	291	
Financial literacy	Pearson Correlatio n		0.036	0.027	.270**	1
	Sig. (2- tailed)		0.003	0.045	0.000	
	N		291	291	291	291
Financial performanc e	Pearson Correlatio n		0.654	0.544*	0.241**	0.476
	Sig. (2- tailed)		0.003	0.014	0.000	0.000
	N		291	291	291	291

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

Source: Researcher (2024)

Equity funding and the financial performance of SMEs are related, according to the results in Table 17 ( $r=0.654$ ,  $p=0.003$ ). With a p-value of 0.003 less than 0.05, the results indicate a strong positive and significant relationship. Debt financing showed a positive significant relationship with SMEs' financial performance ( $r=0.544$ ,  $p=0.014$ ), and there was a positive correlation ( $r=0.241$ ) between retained earnings and SMEs' economic performance. A statistically significant association was further illustrated by the study because the p-value of 0.000 is less than 0.05. Additionally, the results showed a statistically significant positive correlation ( $r=0.476$ ) between financial literacy and SMEs' financial success, with a p-value of 0.000 less than 0.05. These results suggested that the financial performance of the SMEs in Meru County that were supported by the

Uwezo fund improved when different forms of capital structure were used.

#### 4.6.2 Regression Analysis

The association between the dependent variable, financial performance, retained earnings, equity financing, debt financing, and financial literacy was modeled using regression analysis.

**Table 18: Summary Model**

Model	R	R Square	Adjusted R Square	SD. Error of the Estimate
1	.755 <sup>a</sup>	0.624	0.610	0.72094

a. Predictors: (constant), equity financing, debt financing, retain earning, financial literacy

Source: Researcher (2024)

The coefficient of determination (R) for multiple regression models derived from Table 18 regression was 0.755. This suggests that the independent and dependent variables have a positive association. Additionally, it shows that the model's R<sup>2</sup> was 0.624. This indicates that the combination of equity financing, debt financing, retained earnings, and financial literacy may predict 62.4% of the variance in the financial performance of SMEs. Consequently, 37.6% of the variance is caused by additional factors not included in the study.

**Table 19: ANOVA**

Model		Sum of Squares	df	M Square	F	Sig.
1	Regression	3.645	4	0.911	11.753	.000 <sup>b</sup>
	Residual	148.651	286	0.520		

Total 152.296 290

a. Dependent Variable: financial performance

b. Predictors: (Constant), equity financing, debt financing, retain earning, financial literacy

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Source: Researcher (2024)

F statistics were used to examine the model's overall capacity to statistically predict how the independent variables—debt financing, equity financing, retain income, and financial literacy—would affect the financial performance of SMEs in Meru County that get investment from the Uwezo fund. The model's overall significance on Table 19 produced a F statistic value of 11.753 and a p value of 0.000, which is less than 0.05. This suggested that the model generally fit the data well.

#### Regression Coefficients

Table 20 shows the regression coefficient for the study variables

**Table 20: Coefficients**

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	SD. Error			
1 (Constant)	2.200	0.206		10.663	0.000
Equity financing	0.419	0.039	-0.029	-0.489	0.025
Debt financing	0.221	0.038	0.032	0.548	0.004
Retained earning	0.296	0.040	-0.145	-2.438	0.015
Financial literacy	0.332	0.043	-0.044	-0.756	0.000

a. Dependent Variable: financial performance

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Source: Researcher (2024)

The information from Table 20 was used to create the study's regression model, which is discussed in chapter three. The section focuses mostly on the unstandardized coefficients since it includes both a slope component (beta one) and a Y-intercept term (beta zero). The idea behind standardized coefficients was to rescale the variables until the Y-intercept equaled zero.\.

#### Function of Regression

$$2.20 + 0.41X_1 + 0.221X_2 + 0.29X_3 + 0.33X_4 = Y$$

The beta coefficients describe the one-unit contribution of each predictor variable to the explanation of the dependent variable. The regression equation was constructed using the unstandardized coefficients, which comprise the y-intercepts term (beta zero) and slope term (beta one). An unstandardized coefficient beta of 2.200 indicates that the financial condition will be at that level while all other factors (debt financing, equity financing, retained profits, and financial literacy) stay constant. The study shows that a unit increase in equity financing will lead to a 0.419 increase in financial results, a unit increase in debt financing to a 0.221 increase, and a unit increase in retained earnings to a 0.0.296 increase in financial performance when all other independent factors are set to zero. On the other hand, a unit improvement in financial literacy will lead to a 0.332 increase in financial performance assuming all other parameters stay the same. The p-values provide an explanation of the statistical significance of each capital structure element on financial performance. The financial performance of SMEs that got funds from the Uwezo fund was significantly impacted by all four independent variables, as shown by their p values being below 0.05.

## CHAPTER FIVE

### SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

#### 5.1 Introduction

This section summarizes the study's results, conclusions, recommendations, and areas that need more research.

#### 5.2 Summary of the Findings

The results of the study demonstrated that, in comparison to their male counterparts, female entrepreneurs owned and operated the majority of business units. The majority of Meru County's entrepreneurs are young people. This might have happened as a result of government initiatives that empowered women and young people. A stepping stone for the SMEs' ongoing expansion has been made possible by government funding for them through the UWEZO Fund, Women Enterprise Fund, and Youth Fund. However, because they have an undergraduate degree, their intellectual capacity was comparatively strong. While some SMEs gained maturity, the majority were still in their early phases. This showed that even after all this time, the business divisions still needed to move on to the next phase of growth. Only a small percentage of entrepreneurs in Meru County choose to pursue the manufacturing sector, despite the fact that the majority of SMEs are in the service and commerce sector.

##### 5.2.1 Equity Financing and Financial Performance

The main objective of the research was to investigate how internal equity financing affected the financial performance of SMEs in Meru County, Kenya, that were funded by the Uwezo fund. According to the results, most respondents support using reinvested profits as their main source of funding, indicating that they depend on ploughed-back earnings to sustain their companies. Although there are some differences in viewpoints, this perspective demonstrates a moderate level of consistency among participants.

Respondents were ambivalent about holding onto earnings for long-term growth, and their replies were more diverse, suggesting differing opinions about the significance of this tactic. The general perception was that angel investors had little influence in this field and were not seen as a major source of finance. Conversely, there was broad agreement among respondents regarding the importance of friend contributions as a source of funding, especially for partnerships established in business.

### **5.2.2 Debt Financing and Financial Performance**

The second objective of the research was to determine the impact of loan financing on the financial performance of SMEs sponsored by the Uwezo fund in Meru County, Kenya. The findings indicate that respondents generally support using trade credit to finance their businesses, with moderate variability in responses, suggesting a fair level of agreement. Participants also agreed on the use of deferred income to boost working capital, showing a relatively unified view on its effectiveness. Overdraft agreements were perceived to have a significant impact on business operations, despite some variation in responses. Additionally, respondents consistently agreed on financing operations through accrued expenses, showing strong alignment in this area. Mwhile, participants were neutral on leasing agreements for asset acquisition, and they largely disagreed with using factoring as a financing method. However, respondents showed general agreement on using bank loans for financing, with consistent views on its application in their businesses.

### **5.2.3 Retained Earnings and Financial Performance**

Examining the impact of retained earnings on the financial performance of SMEs in Meru County, Kenya, that receive funding from the Uwezo fund was the third goal of the study. Although there is some variation in the responses, the study shows that most respondents support using trade credit to fund their companies. Participants also agree on using deferred income to boost working capital, with responses indicating a stronger consensus on its effectiveness. Overdraft agreements are seen as significantly impacting business

operations, with most respondents agreeing, though there is some variability. Accrued expenses are widely accepted as a financing source, showing strong consistency among responses. However, respondents were neutral about using lease agreements to acquire assets and disagreed on the use of factoring for financing. In contrast, they agreed that bank loans play an essential role in business financing, showing a high degree of consensus.

#### **5.2.4 Financial Literacy and Financial Performance**

Finding out how much financial literacy affects the financial performance of SMEs in Meru County, Kenya, that get money from the Uwezo Fund was the fourth objective of the research. The findings show that respondents believe shorter debt collection periods positively impact financial performance, highlighting the value of timely payments for liquidity and cash flow. There is also consensus on the importance of prequalifying debtors to reduce financial losses from bad debts, reflecting a strong risk management focus. However, respondents were neutral on leadership's ability to predict sales based on experience and were divided on their spending habits and commitment to cost reduction, suggesting varying levels of financial discipline. Opinions on bookkeeping expertise were also neutral, with some respondents feeling competent in financial management while others remain uncertain.

### **5.3 Conclusion**

It was clear from the research that equity financing and the SMEs' economic success were positively correlated. The study's findings reveal that respondents see reinvested profits as a key funding source for their businesses, though opinions on using retained profits for long-term growth vary. Angel investors are regarded as less significant in financing decisions, while there is strong agreement on the importance of financial contributions from friends. This highlights the reliance on personal networks, particularly in partnership

structures. Overall, respondents favor self-financing and social networks in their equity financing strategies.

The study findings highlight that respondent most strongly agreed with the impact of overdraft agreements on business operations, indicating that such agreements significantly influence how firms manage their day-to-day activities. Additionally, there is a high level of agreement and consistency regarding the use of accrued expenses to finance operations, which respondents view as a reliable Ms of supporting their financial needs. The moderate support for trade credit, deferred income, and bank loans as financing tools also demonstrates that these methods are generally accepted and utilized. In contrast, factoring and lease agreements are less commonly used by respondents, suggesting these options are not preferred sources of financing. Overall, the findings emphasize the importance of overdrafts and accrued expenses as key financing strategies in business operations.

The study findings conclude that overdraft agreements and accrued expenses are the primary financing strategies influencing business operations. Respondents show strong agreement on the effectiveness of overdrafts, highlighting their critical role in managing daily cash flow and operational needs. Similarly, accrued expenses are consistently viewed as a reliable source for funding operations, suggesting that firms prefer these methods due to their accessibility and ease of use. While trade credit, deferred income, and bank loans are also recognized as helpful financial tools, they do not hold as strong a preference among respondents. In contrast, factoring and lease agreements are less favored, indicating these options are not commonly relied upon.

The study concludes that effective debt management practices, particularly shorter debt collection periods and prequalification of debtors, are perceived by respondents as critical to enhancing financial performance in SMEs. The consensus on the positive impact of timely debt collection underscores its importance in maintaining cash flow and liquidity,

which are vital for SME sustainability. Similarly, respondents recognize the value of prequalifying debtors as a key risk management strategy to reduce the likelihood of financial losses due to bad debts.

#### **5.4 Recommendations of the Study**

Research concluded that SMEs might benefit from attracting angel investors by creating more transparent business plans and presentations that showcase their expansion prospects. Building networks within the local investment community can also help demystify the process and foster relationships that may lead to future funding opportunities.

Considering the low score regarding the use of factoring as a financing option ( $M=2.43$ ,  $SD=1.020$ ), it is recommended that SMEs invest in educating themselves about the benefits and mechanics of factoring as a viable financing alternative. To facilitate this, businesses could organize informational workshops or collaborate with financial advisors to demystify factoring and showcase successful case studies where it has been effectively employed. The study suggests that firms prioritize short-term, flexible financing options that support operational fluidity.

The study further recommend that SMEs focus on enhancing their understanding and management of retained earnings as a financial resource. This could involve workshops or training sessions aimed at elucidating the importance of retained earnings in funding future projects, maintaining operational continuity, and fostering sustainable growth.

#### **5.5 Suggested Areas for Further Research**

Meru County researchers were driven to find out more about the elements that impact the financial results of SMEs that get Uwezo Fund assistance. Among the subjects that need further research are financial inclusion and its impact on SMEs' financial success. the effect of government assistance via the Uwezo Fund for SMEs on the expansion and

development of SMEs in other counties. The effect of non-financial elements including market share, ownership structure, competitiveness, improved infrastructure, and corporate location on SMEs' financial success.



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## APPENDICIES

### Appendix I: Informed Consent

Researchers in Meru County, Kenya, set out to determine how different capital structures affected the financial performance of SMEs that had received funding from the Uwezo Fund.

Nola, the researcher Eric Mutura has

Phone Number of the Researcher: +254 724927946

Greetings and Objectives

My current academic pursuit is a Master of Business Administration degree from Mount Kenya University. As part of my course requirements, I am conducting research and would like to enlist your help. Finding out how uwezo fund-funded SMEs in Meru County, Kenya fare financially is the driving force for this study.

Research Procedure

Participation is contingent upon your ability to answer questions regarding the following: financial planning; management of donor funds; strategies for financial resource mobilization within your organization; and methods for income generation and diversification. All data will be summarized and utilized exclusively for scholarly pursuits.

The benefits of participating in this study are not specified. To be sure, we hope that the knowledge you receive will help us make your company more financially stable.

Maintaining privacy

The privacy of all collected data will be guaranteed by encrypting it. A code will be provided on each study form to ensure your privacy is protected. All data and files will be safely stored by the primary investigator in a lockable cabinet that is only accessible to those involved in the research. We will safely destroy all information after data analysis.

Engagement on a voluntary basis

Participation in this research is totally optional, and you will not face any consequences if you decide to withdraw at any point.

Participation in this study will not cost you anything.

Inquiries

Contact the Principal Investigator at +254 724927946 or the Chairman of the Mount Kenya University Ethical Review Committee at P.O. Box 342-01000, Thika if you have any questions regarding the research.

CONSENT

I confirm that I have read and understood the information on this form by signing below.

I feel that my questions have been adequately addressed throughout the opportunities to ask them. My participation in this research is entirely voluntary.

Participant's signature \_\_\_\_\_ Date \_\_\_\_\_

Investigator's signature \_\_\_\_\_ Date \_\_\_\_\_



## Appendix II: Questionnaire

While filling out this survey, please be as truthful as possible; however, neither your name nor the name of your company should show anywhere. The data that is obtained will be treated with the highest secrecy and will only be used for study. Choose the options you want and fill out the form.

### PART A: DEMOGRAPHIC DATA

1. Please mark the response of your choice with a checkmark (✓).

Sex: Male ( ) Female ( )

2. Age

18-25 years

26-35year36-45 years

above

46 years

1. What is the most advanced degree you have earned so far? (Select only one option)

Certificate of Primary

Secondary

Diploma

Undergraduate

Postgraduate

2. Position of the respondent:

Manager

Manager and Proprietor Type of Business

Manufacturing

Services



5 = Strongly Agree

4 = Agree

3 = Neutral

2 = Disagree

1 = Strongly Disagree

<b>Equity financing statement</b>		5	4	3	2	1
1	Typically, the company uses ploughed-back profits to refinance the business.					
2	Long-term corporate expansion is financed by retained profits.					
3	One of this company's main sources of funding is angel investors.					
4	Friends' contributions are used to fund the company.					

### **SECTION C: DEBT FINANCE**

11 Please rank the following statements on retained earnings from strongly Agree to Strongly Disagree, where:

5 = Strongly Agree

4 = Agree

3 = Neutral

2 = Disagree

1 = Strongly Disagree

<b>Short term Debt financing statement</b>		5	4	3	2	1
	A company may finance its operations via trade credit.					
	Working capital is enhanced by the usage of deferred revenue.					
	Businesses are affected by overdraft agreements in terms of how they operate.					

The company financed its operations by using accumulated expenses					
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The company purchases assets through lease agreements.					
The business uses mortgages in					
The company financed its operations through factoring					
Bank loan usage has been rising over time					

#### SECTION D: RETAINED EARNING

On the topic of retained profits, could you please rate the following statements as either strongly agree or strongly disagree, where:

5 = Strongly Agree

4 = Agree

3 = Neutral

2 = Disagree

1 = Strongly Disagree

	5	4	3	2	1
Retained earnings should be used for owner use since they are profit.					
When declaring dividend, the retention ratio is not relevant					
Money held in the bank for future use is known as retained earnings.					
Retained earnings must be reinvested in order to foster growth					
Reserve levels are kept constant to guarantee business continuation					
The least expensive source of funding is retained earnings.					

Retained earnings reduce the likelihood of liquidation by lowering the gearing ratio.					
Delaying is preferable to issuing new securities when profits are not high enough to justify investment.					

### SECTION E: FINANCIAL LITERACY

12. Please rank the following statements on financial literacy from strongly Agree to Strongly Disagree, where:

5 = Strongly Agree

4 = Agree

3 = Neutral

2 = Disagree

1 = Strongly Disagree

Statements	5	4	3	2	1
SMEs' financial performance is positively impacted by shorter debt collection timeframes.					
The financial performance of SMEs is improved when borrowers are prequalified before being given credit.					
The SME leadership is knowledgeable and experienced in sales forecasting.					
We emphasize cost reduction and are extremely frugal with our spending.					
Our proficiency in bookkeeping has allowed us to file our tax returns without the need for a professional.					

### SECTION E FINANCIAL PERFORMANCE

13. Concerning the performance of the company, the following claims are made. Please rate your level of agreement with these statements from 1 to 5 by selecting the corresponding box.

In what cases:

5=Strongly Agree

4=Agree

3=Neutral

2=Disagree

1=Strongly Disagree

<b>Financial performance statement</b>	5	4	3	2	1
Using equity financing has improved the company's present profitability situation.					
The company's success is impacted by its liquidity position.					
Use of debt financing is the reason for the high rate of sales growth.					
How well a company does financially is affected by where its funding comes from.					

**Appendix III: ERC certificate**

# Mount Kenya University



REF: MKU/ISERC/4416  
TO: NTALALA ERIC MUTURA

Date: 24 September 2024

REG: MBA/2023/42722 (Amended)

Dear Sir/Madam,

**RE: EFFECT OF CAPITAL STRUCTURE ON FINANCIAL PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES FUNDED BY UWEZOFUND IN MERU COUNTY, KENYA**

This is to inform you that **Mount Kenya University** has reviewed and approved your above research proposal. Your application approval number is **3136**. The approval period is **23/09/2024 - 22/09/2025**.

This approval is subject to compliance with the following requirements;

- i. Only approved documents including informed consents, study instruments, MTA will be used
- ii. All changes including amendments, deviations and violations are submitted for review and approval by **Mount Kenya University**
- iii. Death and life-threatening problems and serious adverse events or unexpected adverse events whether related or unrelated to the study must be reported to **Mount Kenya University** within 72 hours of notification
- iv. Any changes, anticipated or otherwise that may increase the risks or affect the safety or welfare of study participants and others or affect the integrity of the research must be reported to **Mount Kenya University** within 72 hours
- v. Clearance for export of biological specimens must be obtained from relevant institutions
- vi. Submission of a request for renewal of approval at least 60 days prior to expiry of the approval period. Attach a comprehensive progress report to support the renewal
- vii. Submission of an executive summary report within 90 days upon completion of the study to **Mount Kenya University**

Prior to commencing your study, you will be expected to obtain a research license from National Commission for Science, Technology and Innovation (NACOSTI) <https://research-portal.nacosti.go.ke> and also obtain other clearances needed.

Yours sincerely,

**Dr. Alfred Owino, PhD**  
Chairman, Mount Kenya University ISERC



## Appendix IV: Introduction Letter



### DIRECTORATE OF GRADUATE STUDIES

MBA/2023/42722

24<sup>th</sup> September, 2024

*National Commission for Science Technology & Innovation (NACOSTI)  
Off Waiyaki Way, Upper Kabete,  
P.O Box 30623- 00100  
NAIROBI, KENYA*

Dear Sir/Madam,

**RE: NTALALA ERIC MUTURA - REGISTRATION NO. MBA/2023/42722**

The purpose of this letter is to introduce the above named student who is pursuing **Master of Business Administration** in the department of **Accounting and Finance** in the school of **Business and Economics**.

The title of the research is **"Effect of Capital Structure on Financial Performance of Small and Medium Enterprises Funded by Uwezo Fund in Meru County, Kenya."** It has been cleared by the University's Ethics Review Committee (Certificate attached) and now has to proceed to the field to collect data between **October, 2024 and December, 2024**.

Any assistance accorded to the student will be highly appreciated.

Thank you.



**Dr. Samuel M. Karenga, PhD**  
**Director, Graduate Studies**  
Enc.



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Main Campus, General Kago Road, P.O. Box 342-01000 Thika.  
Cell: +254 709 153 000 / +254 709 153 200  
Email: [info@mku.ac.ke](mailto:info@mku.ac.ke), Web: [www.mku.ac.ke](http://www.mku.ac.ke)  
Chartered and ISO 9001 : 2015 Certified Institution.  
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## Appendix V: Research Permit


  
**REPUBLIC OF KENYA**
  
 National Commission for Science, Technology and Innovation


  
**NATIONAL COMMISSION FOR SCIENCE, TECHNOLOGY & INNOVATION**

Ref No: **983890**
Date of Issue: **11/October/2024**

**RESEARCH LICENSE**



**This is to Certify that Mr. Eric Mutura Njalala of Mount Kenya University, has been licensed to conduct research as per the provision of the Science, Technology and Innovation Act, 2013 (Rev.2014) in Meru on the topic: EFFECT OF CAPITAL STRUCTURE ON FINANCIAL PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES FUNDED BY UWEZO FUND IN MERU COUNTY, KENYA for the period ending: 11/October/2025.**

License No: **NACOSTI/P/24/40728**

Applicant Identification Number: **983890**

  
**Director General**  
**NATIONAL COMMISSION FOR SCIENCE, TECHNOLOGY & INNOVATION**

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**See overleaf for conditions**

## Appendix VI: Similarity Index

# NTALALA ERIC MUTURA

## EFFECT OF CAPITAL STRUCTURE ON FINANCIAL PERFORMANCE OF SMES FUNDED BY UWEZO FUND IN MERU...

PROJECT  
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Mount Kenya University

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