A COMPARATIVE ANALYSIS OF THE PERCEIVED EFFECTS OF CONVENTIONAL AND ISLAMIC BANKING PRODUCTS ON THE PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES IN KISUMU, KENYA

A Thesis Submitted to the

Department of Management

School of Business

University of Eastern Africa, Baraton

In Partial Fulfillment of the Requirement for the Degree of

Master of Business Administration

(Finance and Business Management Options)

Assienin Dova Naka Michael Jordan

June 2017

APPROVAL SHEET

This thesis entitled ***A comparative analysis of the perceived effects of conventional and Islamic banking products on the performance of small and medium enterprises in Kisumu, Kenya,*** written and submitted by Assienin Dova Naka Michael Jordan in partial fulfilment of the requirements for the degree of Master of Business Administration (Finance and Business Management), is hereby accepted and approved.

____
Dr. William Ondari
Supervisor

____
Date

____
Mr. Silas Menge
Supervisor

____
Date

Accepted in partial fulfilment of the requirements for the degree of Master of Business Administration (Finance and Business Management).

____
Prof. Corazon Banaga
School Dean

____
Date

____
Prof. Elizabeth Role
Director of Graduate Studies and Research

____
Date

ABSTRACT

The main objective of this study was to compare the effects of conventional and Islamic banking products on the performance of small and medium enterprises in Kisumu, Kenya. Conventional and Islamic banking products are guided by different principles and therefore have different characteristics, terms and conditions which impact on the performance of the users of this products differently. The study utilized data from a sample of 300 SMEs collected using a mixture of convenient and random sampling methods. An equal number of 150 SMEs was surveyed in both systems. Performance indices were computed followed by products utilization indices for both systems. A linear regression analysis was used to identify the marginal effects of each product on the performance of SMEs. Findings from the study Indicated that though both Islamic and conventional banking products have a significant effect on SMEs performance, Conventional banking products tend to have a significant effect on SMEs performance than Islamic products. On the objectives of entrepreneurs, conventional banking products tend to have a more significant effect in helping entrepreneurs achieve their personal objectives though Islamic banking products do help significantly in the achievement of personal objectives of entrepreneurs. Nevertheless, it was found out that there is no significant difference in the extent to which both products help in achieving entrepreneur’s goal. This is due to the fact that not all entrepreneurs attach a financial or market value to their personal objectives. Indeed, mostly Islamic entrepreneurs may not attach financial or market value to their personal satisfaction because Islamic banking is already consistent with their faith and is mostly not market sensitive

ACKNOWLEDGEMENT

I thank God Almighty for his kindness and mercies toward my efforts in achieving this study. I Thank Dr. Willian Ondari and Mr Silas Menge, my supervisors who continuously gave me their time and support, guiding me into doing what is necessary and best for my study. My thanks also go to Prof. Elizabeth Role, Prof. Corazon Banaga, Dr Isaac Owusu Dankwa, the UEAB family, all lecturers and my fellow students as well as all my friends for supporting me in their various capacities. Special thanks go to my father Mr. Assienin Grah Salomon, My mother Mrs Assienin Reine Desire, especially my dearest Brother Awoute Kokou Dzidula Samuel and all my family members who were there for me through hard times. The financial and moral support they gave me will forever be remembered. I cannot forget Miss Musyoka Elizabeth, Assienin Amelia and Andreia Dos Anjos who gave me a lot of support all through.

May God bless you all

DEDICATION

This research is dedicated to my parents, Mr. Assienin Grah Salomon, and Mrs Assienin Reine Desire, for all the love, support and encouragement they gave me in my studies. It is also dedicated to all my relatives for their moral support.

TABLE OF CONTENTS

LIST OF TABLES

LIST OF FIGURES

LIST OF ABBREVIATION AND ACRONYMS

ATM	Automated Teller Machine
DEA	Data Envelopment Analysis
FDS Kenya	Financial Deepening Sector
GDP	Gross Domestic Product
MFA	Meta-Frontier Analysis
MFI	Microfinance Institutions
MOP	Measure of performance
NACOSTI	National Commission for Science, Technology and Innovation
PLS	Profits and Lost Sharing
SACCOs	Savings and Credit Cooperatives Organizations
SSA	Sub Saharan Africa
SPSS	Statistical Package for the Social Sciences
MSEs	Micro and Small Enterprises
SMEs	Small and Medium Enterprises
MENA region	Middle East and North Africa

CHAPTER ONE

INTRODUCTION

Background of the Study

The development and growth of any sector in modern economies has come to heavily depend on the development and performance of the financial system of the economy. This is so because the financial sector provides the necessary investment and operating capital for most economic units in the country. The Small, Medium-sized Enterprises (SME's) (which have been described as engines of economic growth by several scholars in many countries) are not an exception on this. Among the many challenges that SMEs face in their development, growth and survival, the most frequently mentioned is lack of access to affordable credit and other financial services. This therefore requires a continuing evaluation and study of the types, characteristics, terms, conditions and principles of the available financial products and how they impact on the performance of an important sector like SMEs. The purpose of this study is to do a comparative analysis of the effects of conventional and Islamic banking products on the performance of small and medium enterprises in Kisumu, Kenya.

The small and medium-sized enterprise (SME) sector according to Kinyumu (2013), has an important role to play in developing economies, (poverty alleviation and job creation) and this can only be realized through growth of the sector. He goes further to explain that Small and Medium Enterprises (SME's) contribute to macroeconomic goals of nations and their growth is essential for a competitive and efficient market, labor absorption, and production.

Despite these many advantages, the SME sector encounters a lot of problem that critically hinder its progress. In Africa, the SMEs sector though being the back bone of various economies generally find it difficult to raise finance, especially with banks. This phenomenon has compelled SME to seek for various alternatives. Karen, Alberto, and Juan (2010), in their study revealed that people in Kenya face many challenges in accessing financial aid. Problems like high charges and interest rate; lack of collateral and guarantors; lack of required documentation and banking history. This limited access to financial services has over the years been cited as one of the major constraints inhibiting the growth of the Micro and Small Enterprises (MSEs) sector. According to Mohamed, Meryem and Jhon (2016), banks adopt hard information (financial statement analysis) to lend to corporate; they also use soft information (relationship banking) in lending to SMEs. Serving these two types of customer categories simultaneously have significant implications. The elevation of bank cost due to expansion or adoption of relationship banking is one of the key factors which hinder bank's willingness to lend to SMEs.

As SMEs look for affordable financial services Islamic financial services has emerged as an important alternative to the conventional services. The literature comparing Islamic and conventional bank in terms of SMEs lending is scarce in general. Focus of the literature has mostly been on the comparison of *sharia* differences between conventional and Islamic activities. In doing so, the literature overlooks the important difference in the two systems in terms of their lending to SMEs. An Islamic bank doesn't need to go through the same operational complexities that a conventional bank does when lending to SMEs (Mohamed et al, 2016).

There are unique differences in the structure of the lending contract of the two systems. For example, *Murabaha* (rent to own or ownership of property) doesn't need an Islamic bank to set up relationship banking nor employ specialist to deal with SMEs. *Musharaka* basically involve investors in the management of the business, promotes profits sharing but also risk sharing. *Mudaraba* promotes the absence of interest payment and focus more on the profitability of a project while imposing risk on both parties. *Ijarah* contract supports the transfer of ownership of leased properties/assets from the lessor to the lessee at the end of the contract tenor. *Wadiah* corresponds to safekeeping, custody, deposit and trust based on *sharia* terms or laws. *Quard-ul-hassan* (benevolent loan) which is a humanitarian loan not requiring any interest but the principle amount loaned. Looking at conventional, we can list as examples, products like: Term loan which are long term interest-bearing loan; overdraft which are more of a short term interest-bearing loan, which allows users to borrow even when the account is overdrawn; working capital loan which allows borrowers to raise adequate capital for business day to day activities.

This obviously has different cost implication on both banks and the borrowers, mostly SMEs. This what this study addresses by comparing and analyzing how this differences impact on the SME performance.

Statement of the Problem

From the forgoing background information, it is clear that SMEs play an important role in the economic development of many economies. Nevertheless, they continue to face various challenges in their growth, development, and survival, hindering them from contributing to their key roles in the economy. One challenge that is echoed in most literature is the lack of accessibility to credit due to perceived cost and risk by the lenders; particularly from conventional banking.

In recent years, an alternative source of financing to SMEs that is becoming popular in several countries like Kenya, is Islamic banking. As discussed above, Islamic finance is based on *Sharia* law which has led to development of financial products that are structurally different from those of conventional banks. Mohamed et al (2016), explains that an Islamic bank does not need to go through the same operational complexities that a conventional bank does when lending to SMEs. An Islamic bank unlike conventional doesn't need to set up a relationship banking nor employ a specialist personnel to deal with SMEs, for most of its products like *Murabaha.* This therefore entails lower cost to both the Islamic bank and the borrower (SMEs) than conventional banks. This phenomenon therefore brings up differences on Performances particularly on profits and retained earnings.

The literature comparing Islamic and conventional banking in terms of SMEs lending and performance, is scarce. Most literature focuses on the differences between conventional and Islamic banking activities but has not focused on the differences on the performances of SMEs financed by them.

The purpose of this study is to fill this Gap. It focuses on analyzing the impact of the financial products of both Conventional banks like (safe custody, Financial leasing, Checking accounts, overdraft, term loans) and those of Islamic banks like (*Murabaha, mudarabah, musharakah, Ijarah*) , on SMEs performance (Sales, stocks, retained earnings and profitability) in Kisumu, Kenya. The outcome of this comparison is to establish whether products based in Islamic principles are potentially a more viable alternative for SMEs than conventional products.

Research Questions

The overall objective of study is to evaluate and compare the impact of Islamic banking products with those of conventional banking, on the performance of SMEs in Kisumu, Kenya. In order to achieve this objective, the study will address the following questions:

1. What are the conventional and Islamic banking products most commonly utilized by SMEs in Kisumu?
2. Is there a significant difference in the perceived effects of conventional and Islamic products on SMEs financial performance?
3. Is there a significant difference between Conventional and Islamic banking products in their marginal effect on performance index?
4. Is there a significant difference between Conventional and Islamic banking products in their marginal effect on the overall performance of SMEs?
5. How has the utilization of conventional and Islamic banking products, affected the achievement of entrepreneur's personal objectives?
6. Is there a significant difference between the extent with which the utilization of banking products from the conventional and Islamic banks helped in achieving the entrepreneur's personal objectives?

Hypotheses

H_{o1}: There is no significant difference between the perceived effect of conventional and Islamic products on SMEs financial performance.

H_{o2}: There is no significant difference between Conventional and Islamic banking products in their marginal effect on performance index.

H_{o3}: there is no significant difference between Conventional and Islamic banking products in their marginal effect on the overall performance of SMEs.

$H_{o\,4}$: There is no significant difference between the extent with which the utilization of banking products from the conventional and Islamic banks helped in achieving the entrepreneur's personal objectives.

Significance of the Study

This research is of immense importance in the following ways:

It is anticipated that the results and findings of this research will help to give a better insight in the micro-financing sector. These understanding will enable financial participants and leaders to appreciate not only the relevance of micro-financing but also make a better analysis in pointing out efficient and adequate financial model to meet growing demand for financial assistance.

This study will enable scholars in the financial market and institutions to clearly identify the various effect that both Islamic and conventional system through their unique terms and principles have on SMEs and develop strategies and solutions to improve or create better source of financial supports for SMEs. Secondly, the study will be able to create awareness among practitioners in the microfinance industry about the challenges and opportunities that SMEs face due to the kind of services, principles and terms. They will be able to better tailor their business operations to suit SMEs.

For SMEs and entrepreneurs through this study will be able to better understand finance market and institutions and efficiently choose sources of finances that suit their businesses. They will be able to appreciate differences between both Islamic and conventional system and plan for better projects and plans.

This study will also assist the Government in making sound legislations and policies involving banking and financial matters facing both Islamic and conventional micro finance thus making then better performing than there already are. Those policies will also help in addressing challenges faced by SMEs in getting credit and address challenges faced by financial institutions in giving out credit.

Justification of the Study

The main reason this particular research was chosen is due to the many gaps that is yet to be filled. The literature comparing Islamic and conventional banking in terms of SMEs lending and performance, is scarce. Most literature focuses on the differences between conventional and Islamic banking activities but has not focused on the differences on the performances of SMEs financed by them.

Rosnia, Norhazlin, Elmirina and Hishamuddin (2007), conducted a study in Malaysia on Financial Performance of Malaysian Islamic Banks Versus Conventional Banks. This paper analyzed and measured the performance of 2 Islamic Banks (Bank Islam and Bank Muamalat) as they deemed to be the pioneer and spearhead of the Islamic banking system in Malaysia. But the study did not address the perceived effect of Conventional and Islamic banking products on SMEs performance.

Abduallah, et al (2014), in their study comparing Islamic and conventional banking financial performances in Malaysia used accounting ratios which included profitability ratio, liquidity ratio and credit risk ratio to measure the financial performance of the Malaysian banks. Results indicated that conventional banks perform better in profitability, while Islamic banks perform better in liquidity and credit risk. The statistically significant difference was shown in the area of liquidity which means that the Islamic banks liquidity performance has major difference with the non-Islamic banks Islamic banking system. But the study did not address the perceived effect of Conventional and Islamic banking products on SMEs performance.

Ines and Asma (2013), conducted a study on Islamic versus Conventional Microfinance Institutions: Performance analysis in MENA countries. This study focused analysis on the MENA region(Middle east and north Africa), where a large proportion of the poor are practicing Muslims and are thus unable to take advantage of traditional microfinance contracts which are incompatible with *Sharia*'. But the study did not address the perceived effect of Conventional and Islamic banking products on SMEs performance.

This research provides a basis for a better understanding of financial institutions (conventional and Islamic systems), their differences, their principles and terms in relation to small and medium enterprises and makes rooms for better ways and options to enhance financial support in business.

Theoretical Framework

Classical Theory of Interest Rates

According to Gorder (2009), as cited in Solete (2016).The classical theory of interest rates applies the classical theory of economics to determining interest rates. It defines the interest rate as the element that equates savings to investment. The theory compares the supply of savings with the demand for borrowing. Using supply and demand curves the equilibrium rate is calculated by determining the curves intersection point. Thus if savings are greater than investments the interest rate drops until they reach equilibrium and vice versa, if savings are less than investment the interest rate increases until the reward for savings encourages increased savings rates causing the market to again reach equilibrium

Other proponents of the classical theory of interest rates look at it differently. Interest rate is the price paid for the use of capital and that it is determined by the intersection of aggregate demand and supply of capital. According Keynes, interest rates definitely influences the marginal propensity to save. He concludes that the rate of interest should be at a point where the demand curve for capital at different rates intersects the savings curve at a fixed income level. However the classical theory of interest rates fails to account for factors besides supply and demand that may affect interest rates such as the creation of funds, the importance of income and wealth and changes in the primary borrowers in an economy.

Movement of the Demand and Supply of the Loanable Funds

In this theory the demand of loanable funds originates from domestic business, consumers, governments and foreign borrowers. While the supply is generated by domestic savings, dispersion of money balances money creation in the banking system and foreign lending. With these factors determining long-term interest rates, short term interest rates are decided by financial and monetary conditions in the economy (Gorder, 2009).

Profit Theory

The concept of profit is very important for a business or company to ensure that a company can survive. According to economic theory, the profit is derived from the total revenue minus total cost. Profit is also known as the net amount of fixed costs and variable costs which derived from sales in which he is known as the excess of revenue after deducting the expenses and costs. According to Joni and Hadenan, (2006), as cited in Abas (2013), profit can be defined as revenue profits or proceeds from an activity, such as companies, businesses and others in excess of capital and all other related expenses.

These 3 theories are significant for our study in the sense that they touch crucial dimensions of it. First the classical theory of interest give and insight on how interest rate which is generally used by the conventional banking system is determined. It discusses the reason for interest rate payment and the various components which affect it. This theory allows us to understand the logic behind the use of interest rate by the conventional finance system. Secondly, since the study is oriented on SMEs financing, the theory of demand for loanable fund though very brief tells us the origin of the demand from loanable fund, and how it is supplied. Lastly, the profit theory reveals the importance of the concept of profit to a business, since the main aim of a business is to make profit and improve on performance. Looking at our study, we realize that SMEs profits or losses depend mostly on the way it is managed but also on the type of financial support they receive from the various financial or non-financial institutions on the market.

Conceptual Framework

Conceptual framework is a systematic presentation which identifies the variables that when put together explain the issue of concern. The conceptual framework is therefore the set of broad ideas used to explain the relationship between the independent variables (factors) and the dependent variables (outcome). Conceptual framework provides the link between the research titles; the objectives, the study methodology and the literature review (Courtyard, 2004 as cited in Agao, 2014).

The conceptual framework illustrates the relationship between the independent variables which include differences in cost of interest, profit and risk sharing, project financing and cost of default. As shown in figure 1, the independent variable on one hand comprehends both Islamic and conventional products offered by banks to SMEs. Those products aside reflecting the basic principles of both Islamic and conventional finance represent the very tools that banks use to finance SMEs. On the other hand, the dependent variable which is mainly SMEs performance depicts general indicators of performance (increase in sales; returns; level of stocks, retained earnings and profitability). The last element (entrepreneur's personal objectives) which is normally not part of the general indicators has been included to have a better insight on the primary aim or intention to open the business.

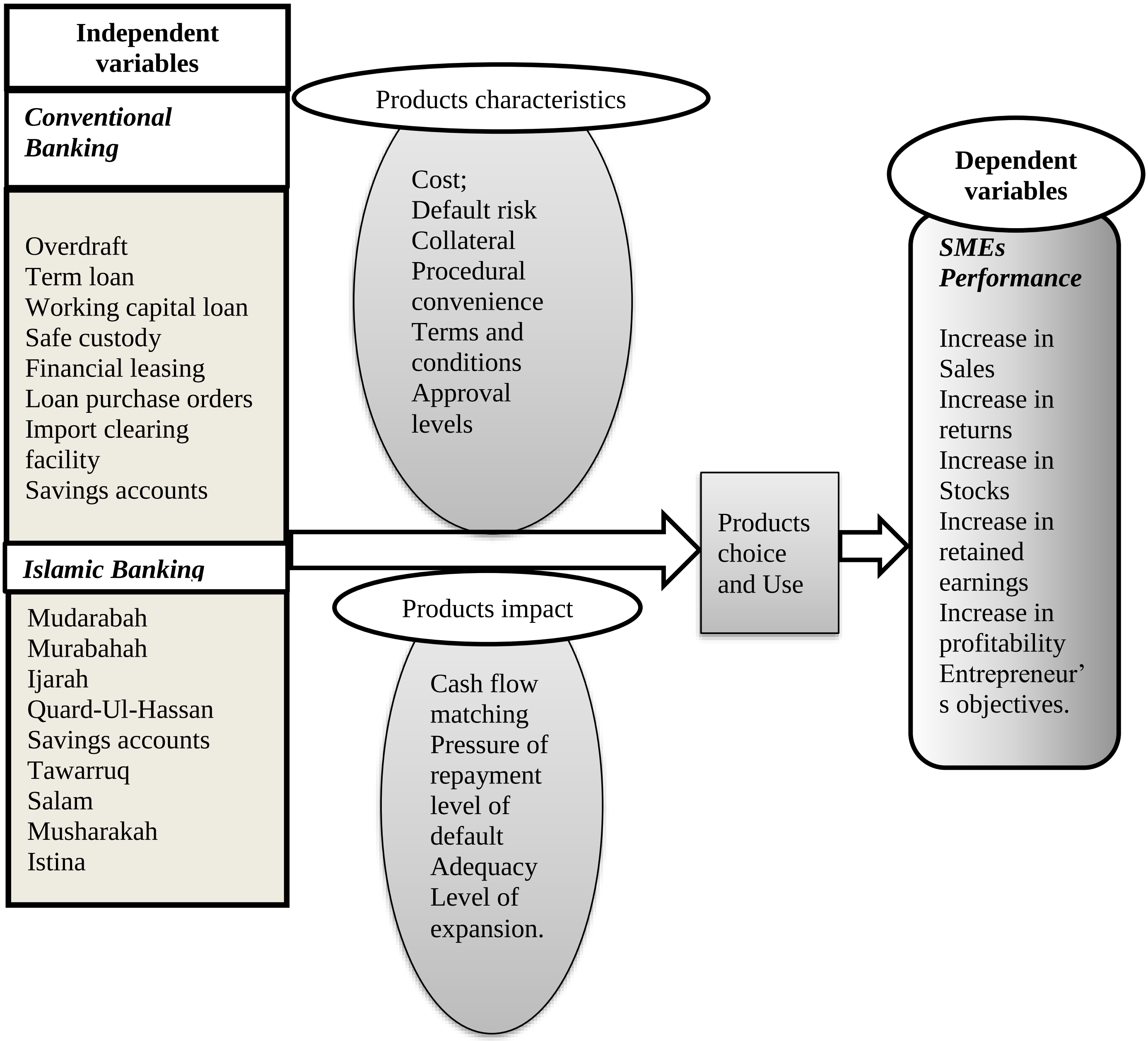

Figure 1. Conceptual framework model.

Source: Author

In figure 1, reveals that the independent variables (Islamic and conventional banking products) possess characteristics which inevitably impact the businesses performance by triggering the choice of customers to use a particular product. Though included in figure1, it’s important to underline that those characteristics and impacts of products are not considered as variables. They have the sole purpose to help understand the process and condition through which the products of both Islamic and conventional affect SMEs performance. The study surveyed those SMEs using conventional products and those using Islamic products to address the research problem. Entrepreneurs by making the choice to selects either conventional or Islamic baking products, base themselves on the various characteristics of the products that can affect increase in sales, stock level, retained earnings, profitability and even help them achieve their personal objectives in putting up their business.

Scope and Limitation of the Study

The study focused on Small and medium sized enterprises in Kisumu among which some receive financial assistance from the conventional banking system, and some from the |Islamic banking system. Various financial institutions are likely to present both the Islamic and the conventional system in Kisumu town. Those include: Kenya Commercial Bank, Barclays Bank, Jamii Bora Bank, First Community Bank and National Bank. This research was limited to SMEs within Kisumu town, Kenya borrowing from either Conventional or Islamic banking.

The findings of this study only analyzed the effect of both Islamic and conventional banking products on SMEs performance in Kisumu, Kenya and nowhere else. Also, the study is only valid for the period in which the investigation is conducted. SMEs that do not work in the same line of study and may not have borrowed at the same period. It is also good too underline that though there are other factors that may affect performance, the study will limit itself to only those mentioned earlier. The study did also not take into account SMEs that use both conventional and Islamic financial products. Furthermore, factors that could be used in the evaluation of

SMEs performance like: Liquidity, Risk management ratio have been left out due to the constrains in collecting the adequate data on the field.

Operational Definition Terms

Financial leasing

It is a type of lease in which a finance company is typically the legal owner of the asset during the duration of the lease, while the lessee not just has operating control over the asset, but also has a substantial share of the economic risks and returns from the change in the valuation of the underlying asset.

Import clearing facility

This involves the documented permission to pass that a national customs authority grants to imported goods so that they can enter the country or to exported goods so that they can leave the country. The custom clearance is typically given to a shipping agent to prove that all applicable customs duties have been paid and the shipment has been approved.

Loan purchase orders

It is a short-term commercial finance option that provides capital to pay suppliers upfront for verified purchase orders. Businesses avoid depleting cash reserves or declining an order because of cash flow challenges. It allows companies to accept unusually large orders and adjust the loan basis up/down quickly to meet needs. If order volume drops, there's no long-term commitment so they can stop using it at any time.

Overdraft

An overdraft is an extension of credit from a lending institution when an account reaches zero. An overdraft allows the individual to continue withdrawing money even if the account has no funds in it or not enough to cover the withdrawal.

Basically, overdraft means that the bank allows customers to borrow a set amount of money. As with any loan, you pay interest on the outstanding balance of an overdraft loan.

Term loan

A term loan is a loan from a bank for a specific amount that has a specified repayment schedule and a fixed or floating interest rate. For example, many banks have term-loan programs that can offer small businesses the cash they need to operate from month to month. Often, a small business uses the cash from a term loan to purchase fixed assets such as equipment for its production process. The loan requires collateral and a rigorous approval process to reduce the risk of repayment. A term loan is appropriate for an established small business with sound financial statements and a substantial down payment to minimize payment amounts and total loan cost.

Working capital loan

A working capital loan is a loan that has the purpose of financing the everyday operations of a company. Working capital loans are not used to buy long-term assets or investments and are instead used to cover accounts payable, wages, etc. Companies that have high seasonality or cyclical sales cycles usually rely on working capital loans to help with periods of reduced business activity.

Savings account

A savings account pays interest on cash not needed for daily expenses but available for an emergency. Deposits and withdrawals are made by phone or mail or at a bank branch or ATM. Interest rates are higher than on checking accounts.

Quard-Ul-Hassan

It is a beneficial loan or benevolent loan or gratuitous loan or an interest-free loan. In *qard hul hasam*, the borrower only repays the principal amount. Because the

Quran forbids paying or receiving interest, *qard hul hasam*is the only permissible loan in Islamic banking. Most Islamic banks provide interest-free loans to customers who are in need. The Islamic view of loans (*qard)* is that there is a moral duty to give them to borrowers free of charge, as a person seeks a loan only if he is in need of it.

Mudarabah

In Islamic finance, *Mudarabah* is a distinct type of partnership, wherein one partner provides the capital to an entrepreneur (another partner) for investing in a commercial initiative, with the objective of sharing profit from the commercial entity. The entrepreneur then undertakes the activities and management of the entity and the profit is shared between the partners in a predetermined quantum, while loss is borne by the investing partners. The investing partner will not interfere in the day-to-day management, but may specify certain conditions related to managing the capital. In other words, he may be referred to as a silent partner.

Murabahah

Murabaha is an Islamic financing structure in which an intermediary buys a property with free and clear title. *Murabaha* is not an interest-bearing loan, which is considered *riba* (or excess), and is an acceptable form of credit sale under *Sharia* (Islamic religious law). Similar in structure to a rent-to-own arrangement, the intermediary retains ownership of the property until the loan is paid in full.

Musharakah

Musharakah is a joint enterprise or partnership structure with profit/loss sharing implications that is used in Islamic finance instead of interest-bearing loans. *Musharakah* allows each party involved in a business to share in the profits and risks. Instead of charging interest as a creditor, the financier will achieve a return in the form of a portion of the actual profits earned, according to a predetermined ratio. However, unlike a traditional creditor, the financier will also share in any losses.

Ijarah

Ijarah means lease, rent or wage. Generally, the *Ijarah* concept refers to selling the benefit of use or service for a fixed price or wage. Under this concept, the Bank makes available to the customer the use of service of assets / equipment such as plant, office automation, motor vehicle for a fixed period and price.

Savings account

"The Bank accepts deposits from its customers looking for safe custody of their funds and a degree of convenience in their use together with the possibility of some profits in the form of Saving Accounts on the principle
The bank requests permission to use these funds so long as these funds remain with the bank. The Bank may, at its absolute discretion, reward the customers by returning a portion of the profits generated from the use of their funds from time to time".

Tawarruq

A Tawarruq is an Islamic financial product which allows clients to raise money quickly and easily, in theory without breaking Muslim bans on interest. A customer buys an easily saleable asset from an Islamic bank at a marked up price, to be paid at a later date, and quickly sells the asset to raise cash. Tawarruq means "turns into silver"

Salam

Bai Salam is a form of forward contract when the price for an asset is paid upfront at the time of the contract for an asset or commodity to be delivered later. it can also be defined as the sale where the Asset/Commodity is delivered on a deferred basis in exchange for the Price be paid immediately. This is different from the idea of

Murabahah where the Price is paid of deferred basis but Asset is delivered immediately.

Istina

An *istina'a* is a contract whereby a party undertakes to produce an asset according to certain agreed specifications at a specific price and for a fixed date of delivery. *Istisna'a* contracts are somewhat unusual in Islamic finance as they do not require the subject matter (eg: a construction project which has not yet commenced) to be in existence at the time of the contract. The price must be fixed at the time the contract is entered into and the specification of the asset must be clearly stated and, in the example above, the financier must bear ownership risk. The technique is particularly useful in providing an Islamic funding tranche element in the construction phase of a project.

Profits and risk sharing

Profit is a financial benefit that is realized when the amount of revenue gained from a business activity exceeds the expenses, costs and taxes needed to sustain the activity. Any profit that is gained goes to the business's owners, who may or may not decide to spend it on the business. Risk on another hand is the possibility of lost; a probability or threat of damage, injury, liability, loss, or any other negative occurrence that is caused by external or internal vulnerabilities, and that may be avoided through preemptive action.

Interest rate

In the study of economics and finance there are several theories that attempt to explain how interest rates affect economies and how they can be used to forecast future changes. These theories include classical, liquidity reference, loanable funds and rational expectations theories (Gorder, 2009).

Source of finance (credit)

A loan or credit is the act of giving money, property or other material goods to another party in exchange for future repayment of the principal amount along with interest or other finance charges. A loan may be for a specific, one-time amount or can be available as an open-ended line of credit up to a specified limit or ceiling amount. Roy (2016), emphasizes that a loan is a debt provided by an entity to another entity (individual or organization) at an interest rate and evidenced by a promissory note which specifies, among other things, the principal amount of money borrowed, the interest the lender is charging, and date of repayment. A loan entails the reallocation of the subject asset(s) for a period of time, between the lender and the borrower. In this bracket we could also talk of micro-credits which have today become a better way to attend to the poor. Galor and Zeira (2012), in their study define microfinance as "the attempt to improve access to small deposits and small loans for poor households neglected by banks. Within any society, microcredit financial services provide a means for people and businesses to obtain credit and manage available assets on a continuous basis (Copestake et al, 2001).

Sales

Sales constitute a critical element in determining performance of a business because it gives much more accurate details on how well the business is actually doing. Sales help to determine if the business is actually generating profit. Credit given to a business that has high level of sale could really help improve financial performance or growth.

Stocks or inventory

Inventory is the raw materials, work-in-process products and finished goods that are considered to be the portion of a business's assets that are ready or will be ready for sale. Inventory is a key indicator of performance because it represents one of the most important assets of a business because the turnover of inventory represents one of the primary sources of revenue generation and subsequent earnings for the company's shareholders.

Retained earnings

Retained earnings refer to the percentage of net earnings not paid out as dividends, but retained by the company to be reinvested in its core business, or to pay debt. It is recorded under shareholders' equity on the balance sheet. The formula calculates retained earnings by adding net income to, or subtracting any net losses from, beginning retained earnings, and subtracting any dividends paid to shareholders.

CHAPTER TWO

REVIEW OF RELATED LITERATURE AND STUDIES

The literature review in this study, first gives an insight on various theories: the microfinance accredit theories which address the implication and processes of microfinancing activities in general; the interest rate and demand for credit which explains the relation between the problem of high interest rates and credit accessibility; the theory of loanable funds which explains how interest rate are determined; the profit and loss theory which explain the profit and loss argument from both conventional and Islamic banking perspectives. Lastly the theory of interest and Islam gives a better insight on the principle of *Riba*.

Next evolution on SMEs in Kenya, the challenges they face and mostly their importance today in the economy; followed by the topic of Islamic banking which explains more on Islamic banking and its *Sharia* compliant basic products, plus the challenges faced by Islamic banking generally. The literature review also addresses the issues of risk management in both Islamic and conventional banking, and points out more differences in their way of operating.

The literature has been selected according to the various differences and challenges both conventional and Islamic banking systems face in general it gives the view of other researchers on the issue of interest rates, profits and loss and risk management. This literature is very important in the sense that it will help in identifying the gaps addressed by the study and have a clear view on the magnitude of the influence of both Islamic and conventional banking products on SMEs performance.

Review of Finance Theories

This section provides a review of the various theories of finance and financing of business in general and small businesses in particular but also gives an insight on the various differences challenges, risks and principles between conventional and Islamic banking products.

Microfinance Credit Theory

Addressing the issue of information asymmetry, this section brings up arguments to shed light on the problem and the possible solutions that should be considered. It is very important to mention that the problem of information asymmetry of one of the first problem that prevent SMEs from raising funds from formal financial institutions.

Responding to challenges of information asymmetry which mostly cause adverse selection and moral hazard, the idea of group lending is mostly seen as one of the principle innovation of microfinance. Rahman (2010), as cited in Simon (2014), concludes that Information asymmetries may lead to the distinct phenomena of adverse selection and moral hazard. In the case of adverse selection, the lender lacks information on the riskiness of its borrowers. Riskier borrowers are more likely to default than safer borrowers, and thus should be charged higher interest rates to compensate for the increased risk of default.

Accordingly, safer borrowers should be charged less provided each type can be accurately identified. Since the lender has incomplete information about the risk profile of its borrowers, higher average interest rates are passed on to all borrowers irrespective of their risk profile. In moral hazard generally refers to the loan utilization by the borrower that is the lender cannot be certain a loan, once disbursed, is used for its intended purpose, or that the borrower applies the expected amounts of complementary inputs, especially effort and entrepreneurial skill, that are the basis for the agreement to provide the loan. If these inputs are less than expected then the borrower may be less able to repay it (Rahman, Davanzo and Sutradhar, 2006). This method can appear to be more useful on the side of the financial institution, but not the side of the customers who are charged high interest rate and charges due to the high profile risk. An alternative should be to use the close monitoring or close relationship lending to augment the trustworthiness of customers and therefore lessen the burden of high charges and interest on them.

Interest Rates and Demand for Credit

This section seeks to shed light on the access of loan and the issue on high interest rate, which to our study prevent SMEs to perform at their best and raise adequate capital.

Helms and Reille (2004), as cited in Solete (2016), drew on available literature to ask whether and how poor people can afford high interest rates. They put forward a number of arguments that question the extent to which high interest rates necessarily hurt the poor. The poor generally consider ongoing access to credit more important than the actual cost of the credit; Studies show that clients benefit from microfinance loans, and that they can and do repay loans; the higher costs of credit have not necessarily excluded poor customers. However, MFIs have succeeded in reaching large numbers of poor clients though Alternatives to credit tend to be very expensive to moneylenders, input suppliers, inflexible and risky local savings circles, or nothing at all.

In a study conducted by Karlan and Zinman (2008), there is an argument that there has been an assumption of “price inelastic demand” (meaning the poor are largely insensitive to interest rates) amongst policymakers. This has provided a foundation for encouraging MFIs to run at sustainable (profitable) interest rates on the basis that it is unlikely to reducing poor people's demand for, or access to credit. To test this assumption, they used an experimental research design to measure the effects of rate fluctuations (of between 50-200 per cent) on uptake of loans by new and existing customers in the case of a South African lender. The study found demand curves were gently downward sloping throughout a wide range of rates below the lender's standard ones, but that demand sensitivity rose sharply at prices above the lender's standard rates. Lower rates produced more borrowing by poor females in the sample. Higher rates also reduced repayment. They also found that "loan price is not the only contracting parameter that might affect demand, and hence MFI profits and targeting. Liquidity constrained individuals may respond to maturity as well, since longer maturities reduces monthly payments and thereby improves cash flows". In fact the study found that maturity "may actually be more influential than price in determining demand for credit if individuals are more concerned with monthly cash flows than interest expenses". In reviewing this study, Roodman (2011), as cited in Solete (2016), points out that the subjects of the study lived well above standard poverty lines of $1 and $2 a day, and their successes revolved around employment, not entrepreneurship. In other words to increase demand for loans and other banking products, financial institutions need to find a way to accommodate low income learning people and small business to increase the demand for interest loans and give a push to the economy in general.

In a recent study, Dehejia, Montgomery and Morduch (2012), as cited in Solete (2016), similarly challenge what they see as a widely-held view among experts in the field that interest rates should be set at profit-making levels on the basis that poor customers are primarily concerned with seeking access to credit, but are not necessarily as concerned with getting "cheap" credit. They argue this assumption is questionable because there is very little evidence of how interest rates affect demand for credit in poor communities. In particular, there are unanswered questions about whether poorer customers are deterred from accessing credit because of higher rates, or whether they are able to pay them. In their case study of the micro-lender Safe Save, operating in the slums of Dhaka, they show that poor households are in fact sensitive to price changes. An unexpected price increase, from a real interest rate around 18 per cent per year to a real rate of around 30 per cent per year (in line with the prices charged by other major Bangladeshi micro-lenders), did affect demand and use of credit services. Elasticities of loan demand with respect to changes in the interest rate ranged from − 0.73 to − 1.04 during the twelve months after the price increase. Moreover, in response to interest rate increases, users altered the way they borrowed taking advantage of Safe Save's flexible lending policy by taking small and more frequent loans and repaying them more quickly. The authors note that it is important to acknowledge that Safe Save did achieve financial stability as a result of the interest rate increase. They suggest that future studies might better explore the heterogeneous impact of interest rate increases on demand for loans.

Rosenberg, Gonzalez and Narain (2009), argues that although interest rates have been the center of debate about credit pricing, and have received the most attention, they are not the only cost that the poor pay in obtaining loans. They emphasize that it is important to keep in mind the other transaction costs for the borrower, including spending time away from their businesses, transportation expenses, and the negative impact of delays in receiving loan funds. These costs are less easily quantifiable but may factor into the decisions that borrowers make about where they choose to obtain loans. In this sense, interest rates are not the only factor that affect demand for and access to loans. The fact that interest rate is not the only factor that influence demand for credit underlines also the fact that borrowers or SMEs performance are not only influenced by bank products but also other factors as cited above. Therefore measures need to be taken from sides of both lenders and borrowers to positively affect demand and business performance.

Loanable Funds Theory

Loanable funds theory was developed by Swedish economist Knut Wicksell in 1851. It assumes that interest rates are determined by supply of loanable funds and demand for credit and that there exists an inverse relationship between the loanable funds and the interest rates. If both the demand and Supply of loanable funds change, the resultant rate would depend on the magnitude of movement of the demand and supply of the loanable funds. In this theory the demand of loanable funds originates from domestic business, consumers, governments and foreign borrowers (Solete, 2017).

While the supply is generated by domestic savings, dispersion of money balances money creation in the banking system and foreign lending. With these factors determining long-term interest rates, short term interest rates are decided by financial and monetary conditions in the economy (Gorder, 2009).

Profit and Loss (PLS) Theory

The profit and loss theory is part of the core different principles between conventional and Islamic banking. This section is definitely important in the sense that it gives an insight on how both systems view the principles of loss and profit sharing.

Conventional banking system generally charge interest for supplying credit to its customers who bear most part of the risk. This credit represents their profit which is generally paid by installment by the borrower. In the case of a deposit or an investment, the bank takes it upon itself to bear the risk and pay interest to the investor considering the term of the contract and the period of time it entails.

This is not the case in the Islamic banking settings. According to Abas (2013), Islamic scholars treat (profit and loss sharing instruments) *mudarabah* and *musharakah* as a central pillar of the Islamic banking model. In *mudarabah* banking, the Islamic bank accepts funds from depositors under risk-sharing arrangements. The Islamic bank either directly invests these funds in profitable investments or extends them to entrepreneurs on a risk-sharing basis. The Islamic bank shares the profit or loss made on *mudarabah* ventures with its depositors. In *musharakah* banking, the Islamic bank contributes the depositors' funds to a joint enterprise with the client (an entrepreneur).

Islam and the Theory of Interest

Ahmad (1952), as cited in Abas (2013), in his book *Economics of Islam* envisaged the establishment of Islamic banks on the basis of a joint stock company with limited liability. In his scheme, in addition to current accounts, on which no dividend or interest should be paid, there was an account in which people could deposit their capital on the basis of partnership, with shareholders receiving higher dividends than the account holders from the profits made. Qureshi (1946), as cited in Abas (2013),in his book on *Islam and the Theory of Interest* looked upon banking as a social service that should be sponsored by the government like public health and education. Qureshi took this point of view since the bank could neither pay any interest to account holders nor charge any interest on loans advanced. Qureshi also spoke of partnerships between banks and businessmen as a possible alternative, sharing losses if any. No mention was made of profit-sharing Abas (2013). There are possible partnership arrangements with the businessmen who seek capital from the banks. However, the partnership principle was not left undefined, nor was it clear who would bear the loss if any. It was suggested that banks should cash bills of trade without charging interest, using the current account funds.

Microfinance Evolution

The Kenyan micro financing industry has come a long way striving to provide financial support to the Kenyan financial market. According to Dondo (1999), Micro financing in Kenya began when the loan board scheme was put up to provide credit to local Kenyan entrepreneurs with small trading business loans. Henceforth, it can be said that the Kenyan microfinance sector is among the most authentic on the continent. In his study, Simon (2014), Support this argument in his study affirming that the inception of the microfinance sector in Kenya had its inception during the 1970s.

According to Nasra (2013), most studies have linked microfinance with positive impact on household welfare. This explains the reason why it is gaining popularity in most countries as one of the strategies of uplifting household welfare. According to Ledgerwood (1999), as cited in Nasra (2013), the term microfinance refers to “the provision of financial services to low-income clients, including self-employed, low-income entrepreneurs in both urban and rural areas.

Today with the efforts of Government, policy makers and technology, micro-finances have been able to evolve into better institutions to carry on their duty. What once started off as microcredit, a simple service offering micro-loans to the world’s unbanked populations, has evolved into complex microfinance markets operated by thousands of MFIs (EY, 2014).

Microfinance Today

According to the Asian Development Bank (2000), micro financing is the provision of a broad range of financial services such as: deposits; loans; payment services; money transfers and insurance to poor and low-income households and their microenterprises.

SMEs despite the numerous effort made by governments and financial institutions still don't have full access to proper financial support from financial institutions. Gallardo, Outra, Randhawa and Steel (2003), indicate that the formal financial sector in many developing countries serves only 5%-20% of the population and the number of institutions is very limited. However, the share of the formal financial sector in total bank assets is about 95%. In other words, poor people in developing countries depend mostly on semi-formal and informal financial intermediaries explains Rabobank (2005). This phenomenon is due to the perceived high risks, high costs involved in small transactions, perceived low relative profitability, and inability of the poor and most SMEs to provide the physical collateral usually required by such institutions. Indeed, SMEs present a high risk to formal financial institutions which find it difficult to provide financial support to them. Lacking access to institutional sources of finance, most poor and low-income households continue to rely on meager, self-finance or informal sources of microfinance. This phenomenon inevitably slows down the economic development because SMEs constitute the back bone of most developing countries today.

According to Asian Development Bank (2000), these lack of funds sources limit SMEs ability to actively participate and benefit from the development process. Underdeveloped communities, suffer the most from lack of financial support Copestake, Bhalotra, and Johnson (2001). Furthermore, the United Nations reveal that while half of the world has no access to bank account, Sub-Sahara Africa (SSA) is the region with lowest share of banked households, at 12 per cent overall by 2009. There is a need to provide better ways and means to make credit available to SMEs in such a way that they could freely operate and foster growth and help underdeveloped communities. Rabobank (2005), in its article explains that providing access to financial services will stimulate the independence and self-development of poor households and micro-entrepreneurs. Microfinance credit is important for the growth and development of Small and Medium-sized Enterprises (SMEs) (Simon, 2014). The premier purpose of microfinance is to supply suitable and well-tailored credit programs that accurately respond to SMEs challenges and risks. Schreiner and Colombet (2001), in their study support that micro-finances normally aim at providing small scales deposits and loans to low income populations not considered by formal institutions.

The rapid expansion of small enterprises in economies of developed countries in the 1980s and 1990s has created a widespread conviction that small, new ventures are the most important source of entrepreneurship and as a dynamic and innovative factor, they contribute directly to economic growth (Idowu, 2010).

Micro financing credit is a credible and effective instrument for poverty alleviation and as such its contribution to economic growth and performance of SMEs. Simon (2014), explains that MFIs are of paramount importance in third world countries like Pakistan as they considerably contribute in poverty alleviation in such countries. The sector has experienced an immense average asset growth up to 39% per annum from the year 2004 to 2008 and accumulated total assets worth $60 billion (Chen, Rasmussen, and Reille, 2010 as cited in Hafiz, Roheel, Bilal and Muhammad, 2014).

According to Rabobank (2005), financial services for the poor in many part of the world, have helped to increase income, build viable businesses, and reduce their vulnerability to external shocks. It has also proven to be a powerful instrument for self-empowerment by enabling the poor, especially women, to become economic agents of change. A recent study on financial access (called FinAccess) in Kenya reveals that 19% of the Kenyan adult population uses financial services from the formal financial institutions which are regulated by the monetary authority like banks and building societies and post office savings bank (Arora and Ferrand, 2007). Alternative formal financial institutions which are not regulated by the central bank, like Savings and Credit Cooperatives (SACCOs) and MFIs, reach 8% of the adult population (George, 2015).

SMEs Today

Importance and Key Challenges

Small and Medium Enterprises (SMEs) are companies whose personnel numbers fall below certain limits. Small enterprises outnumber large companies by a wide margin and also employ many more people. The SMEs sector is considered very important in many economies because they provide job, pay taxes, are innovative and very instrumental in countries participations in the global market. Beck and Kunt (2004) as cited in John and Silvester (2011),state that SMEs activity and economic growth are important because of the relatively large share of the SMEs sector in most developing nations and the substantial international resources from sources like the World Bank group, that have been channeled into the SMEs sector of these nations. In India, the SMEs sector accounts for about 39% of manufacturing output and 33% of total exports. SMEs possess great potential for employment generation, improvement of local technology, output diversification, development of indigenous entrepreneurship and forward integration with large scale industries (Gbandi and Amissah, 2014).

Hölscher, Howard-Jones and Webster (2015),in their study affirm that SMEs are a vital part of the economy and contribute significantly to economic growth. Access to finance, in particular, is important for funding investment, ensuring businesses reach their full growth potential, and for facilitating new business start-ups. SMEs are also said to be responsible for driving innovation and competition in many economic sectors small businesses especially in Africa. Being of a crucial importance to every economy, micro financing institutions as a source of credit help as a channel to give small and medium enterprises the financial support they need, therefore boosting the economy.

In the Kenyan economy, the small and micro enterprises (SMEs) play an important role. According to the Economic Survey (2006), as cited in Michael, Makarius, and Samuel (2009), the sector contributed over 50 percent of new jobs created in the year 2005.According to Evans, Munir, Douglas and Stephen (2015), The Kenya government in the Vision 2030 plan has identified the SMEs as an important priority. In order to achieve performance, adequate sources of finance are needed for SMEs Bank lending to small and medium sized enterprises (SMEs) is important to allow SMEs to start up and finance investment for growth. There has been widespread comment regarding the continued difficulty SMEs perceive in obtaining bank financing since the financial crisis of 2008.In Kenya, the SMEs employs about 5.1 million people representing 74% of the total national employment and also contribute about 88% of the total job creation at any one time; they also contribute in the Gross Domestic Product of the country, whereby they contribute about 24.5% to the GDP (Maina, 2006 as cited in Evans et al, 2015).

Nevertheless, there is a concern that banking systems are not providing enough support to new economic initiatives and in particular to the expansion of SMEs and agriculture sector. Faster economic growth will not be possible without deepening of the financial system and in particular, more financial support from the banking sector to the SMEs. Despite their significance, past statistics indicate that three out of five businesses fail within the first few months of operation (Michael et al, 2009). This phenomenon according to OECD (2015), is due to the fact that traditional lending has been the main source of finance for majority of businesses, giving few alternatives in getting financial debt. Also, many SMEs can rarely meet the conditions set by financial institutions, which are generally conditions on collateral, banking history or appropriate financial records, timely and continuous loan repayment.

Generally, SMEs have more information on their prospect than banks or financial institutions that finance then. Stiglitz and Weiss (1981), argument as cited in Hölscher, Howard-Jones, and Webster (2015), is that information asymmetry in the form of adverse selection and moral hazard is the source of market inefficiency in developing countries and this leads to low risk borrowers, such as SMEs, being sidelined or even excluded from the stream of potential borrowers. This means that banks can turn down loans application for small businesses that may have better profitable prospect simply because of lack of information on these prospects.

While credit is important for SMEs to purchase capital and even expend, there is a negative side to debt particularly in conventional finance sources.

- Interest payment must be made regardless of market condition. This vulnerability is an important factor that firms must consider when making capital structure.

- Ability to service debt becomes problematic when economic condition deteriorates, resulting into insolvency of firms (Trisha, 2011).
- The use of debt present also high interest rate and unaffordable repayment schedules due to pressure of financing firm (Ibid, 2011).

Without finance, SMEs cannot acquire or absorb new technologies nor can they expand to compete in global markets or even strike business linkages with larger firms (Jeniffer, 2014).

This calls for a need to improve the supply of credit to SMEs and find various reliable sources of finance. Ahmed (2002), in his study has recommended the Islamic micro-financing as an alternative to conventional micro-financing due to its in-built characteristics that support Islamic microfinance against conventional. To this effect, the advent of Islamic banking in Kenya has aim to promote justice for all, explains Nur(2013). He goes further basing himself on the (Qur'an 5:2) to reveal that in the last 10 years, Islamic banking has given a big support to the Kenyan SMEs sector in the sense that The principles of interest prohibition on loans and any other services and profit and loss mainly play as a game changer for SMEs. Islamic banks through those principles have brought a new way of doing business in the industry and new opportunities for SMEs which generally encounter problems of lack of collateral, documentation requirement and high interests on loans.

Roy (2016), explains in his study that Islamic banking when introduced to Kenya 10 years ago was used by few but until last year the trend has changed and the system enjoys a growing number of users. In 2016, The National Bank of Kenya opened 25,000 accounts in its Islamic banking window and National Amanah, almost 19,000 of which are held by non-Muslims.

Though Islamic banking is not fully optimized in Kenya, SMEs today have an alternative choice when it comes to financial aids. We can say that Islamic banking has come as a game-changer, bringing new ways of doing business. This new competition will surely redefine the condition of SMEs and hence give a better push to the Kenya economy.

Surely, the differences between conventional and Islamic systems have a crucial influence on SMEs. Looking at SMES in Kenya today, we have On one side the conventional financial institution which are still the main provider of financial support and well implanted in the industry, and the Islamic system which though in the process of being fully established in Kenya continue to prove its value through diverse competitive advantages.

Islamic Banking

The term "Islamic banking" according to Abas (2013), means conduct of banking operations in consonance with Islamic teachings. If there is one distinguishing characteristic of the Islamic economy, it is the prohibition of *Riba.* Abas goes further to explain that the literal meaning of *Riba* is: increase or addition or surplus. In the *sharia*, *Riba* stands for an addition to the principal and, by implication, for a payment for the use of money which has been fixed beforehand. Therefore, Islamic banks are supposed to offer instruments consistent with the religious beliefs and cultural characteristics of Muslim societies. It is compulsory for Muslims to completely avoid *riba* in their commercial and non-commercial daily activities. It is even suggested that a shadow of interest will make a transaction *haram (forbidden).* Apart from interest, other prohibitions include uncertainty, risk taking, ambiguity and investment in unethical and *haram* businesses. These prohibitions make up a wide part of activities of conventional banks (Abas, 2013).

Islamic banking industry is one of the fastest growing industries, having posted double-digit annual growth rates for almost thirty (30) years (Nasra, 2013). According to Abas (2013), Islamic Finance is so far the fastest growing segment in the global financial industry. Despite the global financial crisis, Islamic finance has demonstrated strong growth with new areas of business such as mutual funds and *Takaful* industry attracting a lot of attention. We need to understand this business model that will support our relative comparative advantage in the EAC region. Kenya was the first country in the East and Central African region to introduce Islamic banking. In this regard, two banks were licensed in the last two years to three exclusively offer *Shariah* compliant products with many other conventional banks establishing a window specifically for *Shariah* compliant products.

In many countries including Kenya,there is a lack of knowledge and awareness of the advantageous features of the Islamic form of banking by people and even some governments (Mohamed, 2013). Recent research carried out by Dusuki (2008), concluded that precepts of Islamic banking could assist in the alleviation of poverty by giving the poor access to microfinance facilities based on the concepts of risk sharing and free – interest. If well understood, Islamic banking is a key motor of economic development.

Basic instruments of Islamic Banking

a) ***Murabaha*****:** is an Islamic financing structure in which an intermediary buys a property with free and clear title. *Murabaha* is not an interest-bearing loan, which is considered *Riba* (or excess), and is an acceptable form of credit sale under *Sharia* (Islamic religious law). It is a process by which the Islamic bank buys products needed by its clients (plants and machinery, vehicles, buildings, etc...) and sells them back to the clients at a higher price in installments. In this way, there is no violation of the

(*Riba*) principle. The bank can also charge a fee for continuous daily operations (Alex, 2015).

b) ***Musharaka* (Partnership):** The term refers to a financing technique adopted by Islamic banks. It is an agreement under which the Islamic bank provides funds which are mingled with the funds of the business enterprise and others. All providers of capital are entitled to participate in the management but not necessarily required to do so. The profit is distributed among the partners in predetermined ratios, while the loss is borne by each partner in proportion to his contribution (IIBI, 2016).

c) ***Mudaraba* (Profit sharing):** This is Similar to equity finance or special kind of partnership. The investor provides capital and the business partner operates the business. The profit is shared between both parties however; all loss is to be completely borne by the owner of the capital. In case of loss, the capital owner shall bear the monetary loss and agent shall lose the reward of his effort. *Mudaraba* could be individual or joint (IIBI, 2016).

d) ***Ijara (leasing):*** This is leasing, where the lessee pays rent to the lessor to use an asset. Depending on the agreement, at the end of the rental period, the lessor might take back the asset or might sell it to the lessee. The lessor whatever the agreement remains the owner of the asset and is responsible for maintenance and insurance, thus incurring the risk of ownership (Ibid, 2015).

e) ***Tawarruq :*** Is a financial instrument in which a buyer purchases a commodity from a seller on a deferred payment basis, and the buyer sells the same commodity to a third party on a *spot payment* basis (meaning that payment is made on the spot). The buyer basically borrows the cash needed to make the initial purchase. Later, when he secures the cash from the second transaction, the buyer pays the original seller the installment or lump sum payment he owes (which is cost plus markup, or Murabaha).

Because the buyer has a contract for a Murabaha transaction, and later the same transaction is reversed, this scenario is called a *reverse Murabaha.* Both transactions involved must be sharia-compliant. Tawarruq is a somewhat controversial product. Because the intention of the commodity purchases isn't for the buyer's use or ownership, certain scholars believe that the transactions aren't sharia-compliant. Their argument is that the absence of any real economic activities creates interest, which is prohibited in Sharia.

f) ***Salam:*** Salam financing is a *Shari'ah* compliant transaction, approved from the sayings of the Holy Prophet. It is a special sale contract in which the subject matter does not exist or has not come into existence at the time of payment of the price. The Arabic word Salam is a noun derived from the verb '*aslam'*, which means to advance. Therefore, Salam contract is a mode of transaction in which price is paid before delivery of product. The word *'Salf'* is also used as a synonym for Salam. Before the prohibition of interest, farmers used to get interest based loans for growing crops and harvesting. After prohibition of interest, they were banned to take interest based loans. Because of this prohibition of interest, farmers and specifically small scale farmers faced liquidity problems. Farmers were therefore allowed to take advance price of what farmers are going to grow. When a man involves in Salam and pays for goods to be delivered later, the parties should settle the weight and measure and date of delivery of goods." Says the Holy Prophet. According to all schools of thought, a transaction in which price is paid in advance for the later delivery of goods is Salam. (Asim,Muhammad and Shahzad, 2015)

g) ***Istina:*** A traditional *istina'a ('istina'a')* is an agreement between two parties (the Islamic funder and the construction contractor) whereby the Construction contractor agrees at the outset to construct/manufacture a clearly described/specified PPP project asset for the Islamic funder. The price for carrying out the construction/manufacture will be determined at the time of entering into the agreement, as will the date of delivery of the asset to the funder. Payment of the price may be made as a lump sum on delivery or, as is more common, in instalments linked to the achievement of milestones throughout the construction/manufacturing period. Title to the PPP project asset will pass to the Islamic funder on delivery. (IIBI, 2016).The arrangement requires the Islamic funder to enter into a direct contractual relationship with the construction contractor. This means that the Islamic funder is assuming performance risk — a risk that it will not have much appetite to absorb.

Challenges of Islamic Banking

The Islamic banking and finance industry is still in its infancy stage, and it certainly faces many challenges due to the fact that first, Islamic banks operate in an economy that is driven and manipulated by interest. In a financial economy, the banking sector is supported and regulated by the central bank. The central bank's regulation and policies are created for conventional commercial banks and it acts as lender of last resort. Unfortunately, most Islamic banks do not enjoy such privileges (Abul, 2016).

Secondly, one of the challenges preventing Islamic financing from going fully optimized is a lack of awareness of how Islamic products are structured. Banks would need to make an effort to educate all parties as to how these products operate within the context of SME financing (Jessica, 2016).

Thirdly, Since the Islamic finance industry is working under the secular system, it may suffer from the same systemic problems that contemporary conventional financial institutions are facing. For example, due to lack of proper regulation, Islamic banks do not genuinely engage in risk-sharing, which means defaulting clients of Islamic banks suffer the same consequences as clients of interest-based banks. If Islamic banks engage in money creation, they also will suffer the same inflation and boom-bust cycle that is evident in Western economies (Abul, 2016).

"There is also a general lack of understanding when it comes to Islamic finance when compared to conventional financing; people can be quite skeptical of it. There need to be people who are able to talk about Islamic finance concepts with knowledge and authority to improve awareness" (Jessica, 2016). She added that it is difficult for SMEs to raise funds because banks will not finance them, owing to the risk associated with lending to them; they do not have assets for collateral so the security is not there. But if SMEs do not have access to finance, the sector cannot develop.

Risk Management

This section is of critical importance to our study in the sense that it relates to how conventional and Islamic financial institutions deal with the problem of risk, a problem which has an implication on the performance of SMEs today. In this study, we are able to have a clearer insight on how both conventional and Islamic finance manage Risk.

Conventional Banking and Risk Management

Even though deeply oriented on making profits, conventional banks have designed more than a single way to mitigate risk when lending to SMEs and even bigger businesses. According to FDS Kenya (2015), banks have developed four main technologies that would allow then to lend fund in a more safely manner. These are:

Relationship lending: The bank creates a personal relationship with the firm, its owner and the environment in which they operate, to have a clear idea on who they are really dealing with when it comes to lending money. This concept will help the bank with soft information and give an idea on the capacity of the business to not only take a loan, but meet all the requirements imposed on the loan application process.

Arm length lending: This method unlike the previous one relies on more accurate and formal information. Technologies such as credit scoring, standardized Risk-rating tools and processes, factoring, leasing, etc...Would give a better idea on the financial history of the borrower, how risky and reliable is their business.

Close monitoring: This method involves the bank in a constant monitoring and reporting process with the borrower. Like in the relationship lending model, the borrowing firm would be visited frequently by the bank or lending officer. The aim is to tightly keep close with the borrower and scrutinize every events and actions to make sure the funds are or will be properly used when finally granted.

Automated monitoring: The bank in this type of lending technology relies more on the Transactions that it has had or has with the borrower and the financial statements of the borrower (mostly cash flow).

Islamic Banking and Risk Management

According to AUSAF (1993), the raison d'être of Islamic banking is derived from the Islamic injunction against *riba* (interest). Islamic finance seeks to implement principles of fairness and justice as promotes the Coran by looking at the profitability of a business rather than its credit worthiness. Mohamed (2013), in his study states that the provider of financial capital and the entrepreneur share the business risks in return for a share of the profits. Indeed because of that Islamic banks face risks that are similar to those faced by traditional financial intermediaries and in addition to that, risks that are unique owing to their compliance with the sharia. AUSAF (1993), in his study outlines six principal Islamic products which are the basic tools used to promote sharia law, supply and accept funds and address issues of risk: *Murabahah* (financing on the basis of mark-up or cost plus financing), *Musharakah* (partnership),*Mudarabah* (sleeping partnership),*Ijarah* (leasing), Direct Investment, *Qard Hasan* (interest-free loans) and savings

Murabaha: *Murabahah* is an Islamic financing structure in which an intermediary buys a property with free and clear title. *Murabahah* is not an interest-bearing loan, which is considered *Riba* (or excess), and is an acceptable form of credit sale under Sharia (Islamic religious law). According to AUSAF (1993), it has been estimated that 70 to 80 per cent of the total finance provided by Islamic banks is through *murabahah.* It is a process by which the Islamic bank buys products needed by its clients (plants and machinery, vehicles, buildings, etc...) and sell them back to the clients at a higher price, considering all expenses made in acquiring the product (in installments) (Salesius, 2015). In this way, there is no violation of the *(Riba)* principle. When applying for the contract, the client gives accurate information on the price, nature and availability of the good on the market before the transaction is signed. Nevertheless, the bank faces the risk of the client pulling out from the transaction since the signed transaction is seen as (a promise to buy or sell by the client) non-binding. To overcome the counterparty risks arising from the non-binding nature of the contract, up-front payment of a substantial commitment fee and binding the client on the contract rather than the bank has become permanent features of the contract.

***Musharaka* (Partnership):** The term refers to a financing technique adopted by Islamic banks. It is an agreement under which the Islamic bank provides funds which are mingled with the funds of the business enterprise and others. All providers of capital are entitled to participate in the management but not necessarily required to do so. The profit is distributed among the partners in predetermined ratios, while the loss is borne by each partner in proportion to his contribution (IIBI, 2016).This particular product to succeed and mitigate risk calls to an efficient management and control of any project investment undertaken. The idea of partnership, in other words risk diversification is a great weapon against risk. In this case the banks and its partners will focus mostly on the profitability and feasibility of the project because the probability of loss is everyone's concern.

***Muduraba* (Profit sharing):** This is Similar to equity finance or special kind of partnership. The investor *(Mudarib)* provides capital and the business partner operates the business. The profit is shared between both parties however; all loss is to be completely borne by the owner of the capital. In case of loss, the capital owner shall bear the monetary loss and agent shall lose the reward of his effort and also the efforts and expertise produced to execute the project. *Mudaraba* could be individual or joint. To mitigate risk, banks in this particular case, could act as both investor (*Mudaib*) and agent (Ibid, 2016).

***Ijara* (leasing):** This is leasing, where the lessee pays rent to the lessor to use an asset. Depending on the agreement, at the end of the rental period, the lessor might take back the asset or might sell it to the lessee. The lessor whatever the agreement remains the owner of the asset and is responsible for maintenance and insurance, thus incurring the risk of ownership (Ibid, 2015).

Current accounts (*qard hasan)*: It is a free interest loan to the bank. Full return of the deposit is guaranteed by the bank. But the most important thing to underline is that the bank has the authority to use the fund deposited by the customers at its own risk. This means that any profit made will be kept at the sole benefit of the bank and any loss which will occur will be at the sole risk of the bank (AUSAF, 1993).

Savings "The Bank accepts deposits from its customers looking for safe custody of their funds and a degree of convenience in their use together with the possibility of some profits in the form of Saving Accounts on the principle of *Al Wad_a.* The bank requests permission to use these funds so long as these funds remain with the bank. The depositors can withdraw the balance at any time they so desire and the Bank guarantees the refund of all such balances. All the profits generated by the Bank from the use of such funds belong to the portion of the Bank. However, in contrast with the current account, the Bank may, at its absolute discretion, reward the customers by returning a portion of the profits generated from the use of their funds from time to time" (AUSAF, 1993).

Investment deposits or profit and loss account: unlike the conventional system, this account operates on a principle of profit and loss sharing. (AUSAF, 1993) in his study explains that the depositor is instructed on the ratio that will be used to share the profit, not forgetting the fact that the profit amount will depend on the final result of the investment. According to AUSAF, (1993) while fixed term deposits are usually distinguished from each other on the basis of their maturities; investment deposits can be distinguished on the basis of maturity as well as on the basis of purposes, as it is possible to give special instructions to the bank to invest a particular deposit in a specified project or trade.

Differences between Conventional and Islamic Banking

Conventional banking has for a long time been the standard financial system used in most economies and has proved to be effective all over the world. Nevertheless, Islamic banking though new has also proved to be very effective and well appreciated across several countries. These two systems, (conventional and Islamic banking) are based on various principles and values that constitute the very pillars of their business operations. The next section provides a brief discussion on the key differences between the principles of Islamic Banking and conventional banking that have direct or indirect impact on the differences on the SMEs performance and riskiness.

Principle on Interest

According to Yvonne, Geoff, and Loonat (2011), Islamic banking is different from conventional banking because interest (*Riba*) which is the main variable in conventional financial markets is prohibited in Islam. Islamic banks are not allowed either to offer a fixed rate of return on deposits or to charge interest on loans. There is no taking of any type of prearranged amount over and above the actual principal amount of borrowers (Alex 2011). Islamic financing actually survives without taking interest through its various products tailored to go in line with its *sharia* law based principles. For example: *Murabaha* (rent to own or ownership of property) involves the Islamic bank to buy the property that the customer designs and sell it back to him or her at a higher price including all expenses and terms of agreement.

SMEs borrowing from the conventional system will be compelled to face the cost of interest rate on credit taken while those borrowing from the Islamic system will be able to repay a fix amount charged on the profit earned. Many SMEs in getting financial services face the problem of high charges when applying for conventional banking products and services. The prohibition on interest by the Islamic system may constitute a window for SMEs seeking financial support. Nevertheless the conventional is still the most prominent source of finance and most SMEs would still opt for it.

Cost of Default

Conventional Banks classify all customers' facilities as default when one of the loans is defaulted by customer while Islamic banks only classify default on specific financing unless the other facilities are all offered as a bundle package (including the various facilities in the collateral package).In the event of default by the end user, the financier only has recourse to the items financed, and no further mark-up or penalty may be applied to the sum outstanding, although the seller (the bank) may alternatively require the buyer (borrower) to make a pre-specified donation to an agreed charity (Zaharuddin & Rahman, 2007).

"In certain types of Islamic financing, on a default, the amount claimed will include a profit element that is calculated over the full finance period. In contrast, with a conventional financing, the amount of interest is that which has accrued up to the occurrence of an event of default. The conventional lenders may, therefore, feel that the Islamic financiers' pro rata entitlement to a share in any enforcement proceeds (based on amounts outstanding) means that they benefit more than the conventional lenders. A sharing mechanism must, therefore, be found if equality is the commercial deal" (Zaharuddin and Rahman, 2007). On the side of the SMEs, most would opt to go for the Islamic system which seems more flexible on asset acquisition in times of default or bankruptcy.

Profits and Risk Sharing

Looking at profit and risk sharing, Ali (2016), explains in his study that, the investor is assured of a predetermined rate of interest in the conventional system, while Islamic banking promotes profit and risk sharing between investor and the user of fund, there is no predetermined rate. The borrower and the lender share profits as well as losses arising from the venture started with the finance obtained from the lender(Alex, 2011).This principle to SMEs brings bundles of opportunities when it comes to investing funds. The Islamic system which appears to be fair in sharing loss in times of uncertainty may attract more SMEs when it comes to borrowing. Looking at *Muduraba* (Profit sharing): The investor *(Mudarib)* provides capital and the business partner operates the business. The profit is shared between both parties however; all loss is to be completely borne by the owner of the capital. In case of loss, the capital owner shall bear the monetary loss and agent shall lose the reward of his effort and also the efforts and expertise produced to execute the project. *Mudaraba* could be individual or joint. To mitigate risk, banks in this particular case, could act as both investor (*Mudarib*) and agent (IIBI, 2016). This system may provide great opportunities for SMEs which struggle most of the time when it comes to managing losses in the conventional system. Nevertheless there will be a need for Islamic financial institutions to come up with more ways to handles SMEs which tend to fail projects on the long run. In other words, the principle of profit and loss sharing may yet be a tool of competitive advantage but is not fully optimized for Islamic system depending.

Cancellation of Contract

According to Zaharuddi et al (2007), a conventional Bank has the right to cancel contract at their sole discretion (during events of default or if customers financial position becomes critical or is of higher risk to the bank) and change the terms and conditions by way of giving sufficient notice to customers. On the other hand, an Islamic Bank only has the right to change the terms and conditions by giving sufficient notice to customers if the change benefits the customers and do not have the right to cancel contract at their sole discretion. It is rather a mutual decision. This implies that SMEs dealing with the conventional system may not be aware of the termination of contract especially when the interest of the bank is at stake. On the other hand, SMEs dealing with the Islamic system would receive notice in case of termination of contract.

Investment Principle

Islamic banking does not permit transactions in most derivatives like: bonds, future, forwards and option contract. Ali (2016) supports that it rather promotes avoidance of economic activities involving speculation Futures trading in stock and commodity markets, currency options, currency swaps, short selling and other complex derivatives are not allowed in Islamic banking. In addition, Alex (2011) reveals that the prohibition on investing in businesses such as selling alcohol or pork; or businesses that produce media such as pornography or gossip columns and gambling industry are considered unlawful. today, though all those conventional derivatives have been tailored in a way that principles of interest (*Riba*) and profit and loses sharing are not affected, most SMEs still find the conventional derivatives more beneficial because it has more opportunities and benefits since the prohibition on conventional derivatives is more oriented on the religious idea like the dealing of alcohol or pork; or businesses that produce media such as pornography or gossip columns and gambling industry.

Profit Making

On this principle, Zaharuddi et al (2007), indicates that Islamic banking aims at maximizing profits but subject to *sharia* restrictions when conventional banks has unrestricted profits maximization illustrated by derivative trading. For the conventional system, money is a commodity besides medium of exchange and store of value. Therefore, it can be sold at a price higher than its face value and it can also be rented out. On the contrary, money is not a commodity in Islamic banking though it is used as a medium of exchange and store of value. Therefore, it cannot be sold at a price higher than its face value or rented out. If money has to be exchanged for money or is borrowed for exceptional reasons, the payment on both sides must be equal so that it is not used for any purpose for which it is not meant to be used. Islam does not recognize loans as income generating transactions. This means therefore that SMEs could widely benefit from the Islamic system when it comes to profit making because the Islamic system tries to make profit but at the same time looks out for equality and fairness according to the Coran. But it’s also good to underline that not all SMEs would be willing to shift from the conventional system knowing that Islamic banking in Kenya is still young and still has issues in establishing its policies and principles.

The main differences between conventional and Islamic finance are principles of interest and profit and risk sharing principles. SMEs though more familiar with conventional products find greater opportunities in principles of absence of interest and profits and risk sharing. These differences between both Conventional and Islamic banking surely influence SMEs in various ways.

Review of Empirical Studies

Islamic and conventional banking have for long being studied by many scholars and researchers who have tried to distinguish their differences and similarities. The literature comparing Islamic and conventional banking in terms of SMEs lending and performance, is scarce. Most literature focuses on the differences between conventional and Islamic banking activities but has not focused on the differences on the performances of SMEs financed by them.

Abduallah et al. (2014), in their study comparing Islamic and conventional banking financial performances in Malaysia used accounting ratios which included profitability ratio, liquidity ratio and credit risk ratio to measure the financial performance of the Malaysian banks. Results indicated that conventional banks perform better in profitability, while Islamic banks perform better in liquidity and credit risk. The statistically significant difference was shown in the area of liquidity which means that the Islamic banks liquidity performance has major difference with the non-Islamic banks Islamic banking system. Even so, it good to underline that there are other factors that affect financial performance of financial institution, like risk management, Customer relationship management, employee satisfaction etc..., though Islamic banking tend to appears less performing, it still present numerous advantages and opportunities for SMEs.

Hafizet et al. (2014), in their study devised to compare the efficiency of the conventional versus Islamic Microfinance institutions in Pakistan have used a non-parametric approach was used to evaluate the efficiency of the targeted institutions. Among those, 9 Conventional microfinance institutions and 3 IMF institutions were used spanning over a period of 4 years that is 2008 to 2011. The results revealed that 2 out of 3 IMF institution and 2 out of 9 conventional MFIs were found on efficient frontier. Therefore, the sustainability of Islamic Microfinance institutions can be rated as high in Pakistan and this mod of financing should be encouraged by policy makers. This phenomenon must also be explained by the fact that Pakistan is an Islamic country where people are likely to embrace Sharia compliant finance rather than conventional product which encourage interest rate practices.

Ines and Asma (2013), conducted a study on Islamic versus Conventional Microfinance Institutions: Performance analysis in MENA countries. This study focused analysis on the MENA region(Middle east and north Africa), where a large proportion of the poor are practicing Muslims and are thus unable to take advantage of traditional microfinance contracts which are incompatible with *Sharia*'. Using a non-parametric data envelopment analysis (DEA) to estimate the efficiency of the microfinance institutions. The Study showed no significant differences in the efficiency of the two groups. It was therefore concluded that the religion and more specifically the use of *Sharia*-compliant products does not affect the efficiency of MFI in the MENA region. On another hand, it can be discussed that the use of *sharia* compliant products do not affect Islamic microfinance performance because of the lack of familiarity of customers with the product. Undertaking a similar study with a linear regression also can bring a more precised result that type of analysis brings about the cause-effect element in a more effective manner than the non-parametric method

Rosnia, Norhazlin, Elmirina and Hishamuddin (2007), conducted a study in Malaysia on Financial Performance of Malaysian Islamic Banks Versus Conventional Banks. This paper analyzed and measured the performance of 2 Islamic Banks (Bank Islam and Bank Muamalat) as they deemed to be the pioneer and spearhead of the Islamic banking system in Malaysia. Both banks were then benchmarked against the conventional banks' performance over 5 years (2004-2008). It was found that Islamic banks are less profitable but have better liquidity than conventional banks. The higher profitability of conventional banks is due to the higher net financing and better asset quality that they have, and also with regards to efficiency, Islamic banks are more profit efficient than conventional counterparts.

Jill, Marwan, and Vasileios, (2012), in a comparison of performance of Islamic and conventional banks 2004 to 2009,using data envelopment analysis, found that there is no significant difference in mean efficiency between conventional and Islamic banks when efficiency is measured relative to a common frontier. However, Meta-frontier analysis (MFA), revealed some fundamental differences between the two bank categories. In particular, the efficiency frontier for Islamic banks typically laying inside the frontier for conventional banks, suggesting that the Islamic banking system is less efficient than the conventional one. Managers of Islamic banks, however, make up for this as mean efficiency in Islamic banks is higher than in conventional banks when efficiency is measured relative to their own bank type frontier.

Babar, Majid, Bibi, Isra, and Muhammad (2014), conducted an investigation on a comparison of Islamic and conventional banking practices regarding house finance in Pakistan: a case of Hazara division. Quantitative research methodology was used while 120 respondents were selected from both Islamic and conventional banks from Mansehra and Abbottabad districts. Data was collected from respondents with the help of questioners on five liker scale. It was found that Customers and the society are more benefited from the Islamic banks products for home financing. We can discuss that this phenomenon is due to religious affiliation of most Pakistani to the Islamic religion. In total they feel Islamic banking more adequate or appropriate.

Nasra (2013), studied on the influence of Islamic microfinance products on the welfare of Muslim community in Kisumu municipality, Kenya. The study adopted random sampling technique to obtain a sample size of 318 out of a population of 1859. It was established that though the rate of uptake of the Islamic microfinance products is very moderate, Islamic microfinance has an impact on the welfare of Muslims who use it. Nevertheless measure needed to be taken to solve problems like lack of awareness about the products, products being expensive to access since they require collateral and are authorized from head office.

Abas (2013), conducted a study on the effect of Islamic banking on investment financing in Islamic banks in Kenya. He used a descriptive survey design and population of eight commercial banks offering *shariah* compliant products. The study indicated that there were various modes of financing used by Islamic banking such as profit and loss sharing, *Ijara* and *murahaba* and also that motor vehicle financing was statistically significant in explaining loans advanced to customers in Islamic banks. However mortgage financing, asset financing, real estate financing, trade financing and SME financing were not statistically significant in explaining loans advanced to customers in Islamic banks but they were positively correlated.

Mohamed (2013), in his study on the factors influencing the growth of Islamic banks in Kenya, revealed that the main challenges faced by Islamic Banks in Kenya include Stiff competition with the conventional system and the shortage of professionals in the Islamic banking sector, since respondents felt that the bank personnel is not fully conversant with the concept. Training of personnel qualified in Islamic banking, Promotions and marketing need to be carried on according to the study.

Summary of the Key Issues in the Literature

From the literature review, is evident that both Islamic and conventional banking systems both present various terms and principles which are proven to be effective according to the area or country they operate.   In Kenya, though the difference between conventional and Islamic banking is quiet well known, there is still a lot that needs to be done for Islamic banking to be fully optimized. The literature on Islamic and conventional banking financing Small businesses in still scares and SMEs and no insight is given on how Islamic and conventional banking products affect SMEs. Nevertheless, the Islamic banking system has proven itself to be very effective when it comes to meeting the critical demand for credit on the market. SMEs in Kenya are now able to raise their expectations when it comes to financial growth and credit access.

Research Gaps

Around the world, while conventional microfinance institutions have expanded their operations in the last two decades, poverty-focused microfinance based on Islamic principles is also growing rapidly. Though the system of Islamic banking is still new in Kenya as explained by Mohamed (2013), Islamic banking in Kenya has proven to be very effective in meeting the growing need for finances. In his study Abas (2013), underlined that Kenya was the first country in the East and Central African region to introduce Islamic banking and that the Islamic banking products have spread like a bush fire in the Kenyan banking sector as all the financial products have been used to a high percentage across the years.

Most studies have focused on comparing or studying both conventional and Islamic banking and terms of performances or in terms of their various differences and ways of doing business. But no actual study that has been made on the effect of the banking products of those two systems (conventional and Islamic) on Small and medium enterprises in Kisumu town. Not forgetting that Financing of small and medium scale enterprises is essential for creating employment and economic growth, this study is geared to examine the influence that those particular distinct products have on SMEs in Kisumu, Kenya

CHAPTER THREE

RESEARCH METHODOLOGY

This chapter discusses the research methodology followed by the study in data collection and analysis to meet the objectives of the study. It describes the research design, the population and sampling procedures it also present the treatment of the data, and the analysis including both the descriptive and the inferential procedures.

Research Design

Research design refers to the way a study was planned and conducted, the procedures and techniques employed to answer the research problem or question (Saunders, Lewis, and Thornhill, 2009). It constitutes all the arrangements of conditions for data collection and analysis of data so as to systematically solve the research problem (Kothari, 2004). The research design explains the pattern the researcher intends to follow in this study. The researcher adopted a cross-sectional survey for the study. In this type of research study, either the entire population or a subset thereof is selected, and from these individuals, data are collected to help answer research questions of interest. It is called cross-sectional because the information about X and Y that is gathered represents what is going on at only one point in time (Chris and Diane, 2004).

Target Population

A population is the entire collection of all observations of interest (people, objects or events) as defined by the researcher (Burns and Burns, 2008). The target population for this study was 7000 SME's from all the licensed businesses within Kisumu County (Data from single business permit licenses Kisumu county council 2012) (Kinyumu, 2013).The target population of the study covered Small businesses which get financial services from either conventional or Islamic banks within Kisumu town.

Sampling Techniques

A minimum sample size depends on the type of research study being conducted. The study selected SMEs operating in Kisumu which borrow from either from the Islamic or the conventional system, using purposive research approach to carry out the study. This method is also known as judgment, selective or subjective sampling technique in which researcher relies on his or her own judgment when choosing members of the population to participate in the study.

The following formula will be used in determining the sample size of the study. The researcher also adopted a purposive research approach to carry out the study. This method is also known as judgment, selective or subjective sampling technique in which researcher relies on his or her own judgment when choosing members of population to participate in the study

$$n = \frac{N}{1 + Ne^2} \quad : \qquad . 3.1$$

Where: n = sample size

N = population size

e = margin of error ($e \leq 0.05$)

For the purpose of this study, a sample of 378 respondents (one respondent out of each SME) was selected out of the population of 7000 in the community of Kisumu based on the above formula:

$$n = \frac{7000}{1 + 7000(0.05)^2} = 378$$

Due to the fact that the 7000 SMEs are from all licensed businesses within Kisumu County and the research only focuses on the town of Kisumu, The researcher issued

350 questionnaires, on the basis that Kisumu town might have a lesser number of SMEs. Therefore, targeting 350 respondents in Kisumu town was an appropriate sample size to build the study on.

Research Instrument

The main instrument that was used for collecting data for this study is a questionnaire which is defined as a self-contained, self-administered instrument for asking questions. The questionnaire was formulated from proper conceptualization of review of literature. Each research question and variables was considered in the questionnaire. It captured the major variables as specified in the conceptual framework.

In this study, the questionnaire was divided into 4 sections.

Section A: dealt with the background information on the business. Basic information that helped to know which kind of business we are dealing with.

Section B: dealt with information on banks products (Islamic and conventional) and their utilization. Section C: dealt with the effects of bank products on SMEs performance with basically two parts. One for an Islamic use only and the other for conventional use only Section D: dealt with the entrepreneur’s personal objectives when putting up the business.

In the questionnaire, the main variables measure included the financial products of both Islamic and conventional systems; performance measures and products characteristics and products impact on the performance.

These measures were captured using the Likert-type response of the participants on their perceived level of utilization of financial products; performance level; challenges and Achievement of other business objectives. For example, four utility will be presented to respondents and asked to give the level of importance on a scale or 6 point Likert scale.

To the question of frequency of utilization of any financial product may it be Islamic or conventional, the interpretation is a follows: 1.00 - 1.49 – Never; 1.50 – 2.49 – Rarely; 2.50 – 3.49 – Occasionally; 3.50 – 4.49 – Sometimes; 4.50 – 5.49 – Frequently; 5.50 – 5.00 – Every time.

To the importance and use of the bank products to the business: The interpretation of the mean is as follows: 1.00 - 1.49 – No importance; 1.50 – 2.49 – Low importance; 2.50 – 3.49 – Slightly important; 3.50 – 4.49 – Neutral; 4.50 – 5.49 – Moderately important; 5.50 – 5.00 – Very important

To Reason and Level of importance for the choice of utilizing the product

The interpretation of the mean is as follows: 1.00 - 1.49 – Not a reason; 1.50 – 2.49 – Low importance; 2.50 – 3.49 – Slightly important; 3.50 – 4.49 – Neutral; 4.50 – 5.49 – Moderately important; 5.50 – 5.00 – Very important

For the severity of the constraints in taking bank products

Scale of interpretation of the mean is as follows: 1.00 - 1.49 – Not a constraint; 1.50 – 2.49 – Not serious problem; 2.50 – 3.49 – Less serious; 3.50 – 4.49 – Moderate problem; 4.50 – 5.49 – Serious problem; 5.50 – 5.00 – Very serious problem

To the question "What is the effect of conventional and Islamic bank products on SMEs' financial performance?" the scale of interpretation of the mean is as follow: 1.00 – 1.49 – No effect; 1.50 – 2.49 – Minor effect; 2.50 – 3.49 – Neutral effect; 3.50 – 4.49 – Moderate effect; 4.50 – 5.00 – Major effect.

To the question to what extent has the utilization of banking products from the bank helped in achieving the entrepreneur's personal objectives? The Scale of interpretation of the mean is as follow: 1.00 – 1.49 – Less extent; 1.50 – 2.49 – Moderate extent; 2.50 – 3.49 – Large extent; 3.50 – 4.00 – Very large extent.

Questionnaires is one of the most common and popular tools to gather data from a large number of respondents and have advantages over some other types of surveys in that they are less expensive, do not require as much effort, and often have standardized answers that make it simple to compile data (Zikmund, Babin, Carr, & Griffin, 2012).

Validity of the Research Instrument

Validity of an instrument is the success of the scale in measuring what it sets out to measure so that, the differences in individual scores can be taken as representing true differences in the characteristics under study (Kothari, 2004). The instruments for data collection was sub-divided as per the variables and objectives to ascertain whether the content was comprehensive and representative of the behavior domains that were measured. Content validity of the instrument was determined through examining how other researchers had coped with a similar data set in a similar context. The questionnaire was presented to scholars in the school of Business Administration at the University of Eastern Africa, Baraton and the thesis supervisors for both content and face validity. Other suggestions for change was incorporated in the final instrument used in the study.

Reliability of the Research Instruments

An instrument is considered reliable when it is able to elicit the same responses each time it is administered. Any random influence that tends to make the measurement different from occasion to occasion is a source of error unless the differences are such that they maximized systematic variance.

For a research instrument to be reliable, it must demonstrate that if it were to be carried out on a similar group of respondents in a similar context (however defined), then similar results would be found. Poor reliability degrades the precision of a single measurement and reduces ability to track (Mislevy, 2007). For the current study, the pilot study was undertaken in the town of Eldoret which also contains a considerable number of SMEs which enjoy services of both Islamic and conventional banking. During the reliability test, the researcher came to understand that most Islamic banking customers were not familiar with the Islamic terms listed in the questionnaire. Thus, appropriates Islamic banking terms for Islamic products generally used in Kenya have been incorporated in the questionnaire to help respondents have a better understanding of what is asked of them.

Cronbach's alpha coefficient was computed for the questionnaire to be considered for final data collection the Cronbach alpha coefficient for the Islamic questionnaire was: Section C (Conventional): greater than .847 and section C (Islamic): greater than 0.852.

Data-gathering Procedures

Mainly primary data was used in this study. Questionnaires was used as the instrument of data collection and was designed to collect data addressing all research questions. In developing the questionnaire items, the fixed choice and open-ended formats of the item was considered. After validating the instrument, the researcher got letters from the director of Graduate studies which was addressed to the respective entrepreneurs to allow the researcher to gather data. The researcher personally visited the various SMEs with the help of a guide who is fluent in Kiswahili and very familiar with the environment for a total period of four days and met with the managers or entrepreneurs to be granted permission to administer questionnaires. After being granted permission, the researcher distributed the questionnaires at various SMEs, particularly to entrepreneurs, at an adequate time for them to properly fill the questionnaires. Findings were presented in a narrative form enhanced by numerical, categorical, and graphical illustrations where applicable after data has been collected through the use of questionnaires from respondents who are all entrepreneurs, in other words Business owners.

Statistical Treatment of Data

The data that was tallied, collated, and entered into the Statistical Package for the Social Sciences (SPSS). The analysis was done in two stages.
First, it was analyzed to get descriptive statistics mainly the socio-economic profile of businesses and their owner or manager. Next, analysis involved causal and inferential statistics analysis and also T-test analysis was done.

Linear regression analysis between the performance measures of SMEs and the products of both Islamic and conventional banking was done. Before further study was done, some transformation of the variables was carried out to generate variables that measure the performance and effect of the products. Since it was difficult to access actual financial figures on SMEs performance, due to the reluctance of respondents to provide such information. Past studies having also pointed out this problem have used as an alternative the Likert-type scale, which is what our study has adopted. This method has helped in setting respondents opinion, perception and evaluations of the variables both in the performance and utilization of the products. For example, looking at the performance of the business, the respondents were asked to indicate how a particular financial product has affected their specific measure of performance on a scale ranging from: 0- the product was not used; 1-used but no effect to 5-major effect. On the utilization of the product, they were asked on the frequency of utilization of financial products ranging from: 0-never utilized; 1-rarely to 4-a great deal.

From these measures, the data was transformed and summarized to generate the variables that were utilized for inferential analysis of the result. The first such variable was the measure of performance index (MOP) which is the dependent variable. This was computed by taking the average Likert scores on the perceived effectiveness of each product on each of the performance measures like: Increase in sale; increase in stock level; increase in retained earnings and increase in profitability. The independent variable which is the level of utilization of each product was computed by setting the average Likert score on the frequency of utilization of each product. A multiple regression analysis was done of the (Measure of performance index on each product utilization index).

The overall significance of the regression was used as the basis of comparison between the two types of products. Using the Likert scale, the regression equation was specified as follow:

Conventional banking :

$MoP=C_0+C_1X_1+C_2X_2+C_3X_3+C_4X_4+\ldots\ldots\ldots..+C_jX_j+E$ *3:2*

Where: MoP =Measure of performance which is the mean of the Likert scale scores of the effectiveness of each products (dependent variable)

C0 = regression constant for conventional banking

Cj=regression coefficient for each independent variables Xj=1, 2, 3, 4…….n

E=Model error

X_1=Overdraft X_2=Working capital Loan X_3=Term loan

X_4= import clearing facility X_5= Financial leasing

X_6= Savings accounts X_7= Loan purchase order

According to this model, a change in the frequency of use of conventional Banking products (X_1, X_2, X_3, X_4, X_5, X_6, and X_7) produces a change in the dependent variable (MoP).

Islamic banking:

$$MoP=B_0+B_1X_8+B_2X_9+B_3X_{10}+B_4X_{11}+\ldots\ldots\ldots..+B_jX_j+E \qquad \textit{3:3}$$

Where: MoP = Measure of performance which is the mean of the Likert scale scores of the effectiveness of each products (dependent variable).

B0 = regression constant for Islamic banking

Bj=regression coefficient for each independent variables Xj=1, 2, 3, 4…….n

E=Model error

X_8= (Murabaha) X_{10}= (Ijara) X_{12}= (Savings)

X_9= Mudaraba X_{11}= (Qard-hul-hasan) X_{13}= (Tawarruq)

X_{14}= (Salam) X_{15}= (Musharaka) X_{16}= (Istina)

According to this model, a change in the frequency of use of Islamic banking products (X_8, X_{10}, X_{11}, X_{12}, X_{13}, X_{14}, X_{15} and X_{16}) produces a change in the dependent variable (MoP).

Ethical Considerations

Respondents' information was treated with confidentiality. No section of the questionnaire revealed respondent's privacy. The proposal was also presented to the Research Ethics Committee of University of Eastern Africa, Baraton, which after going through the document approved it and issue out a letter of approval. Before conducting the study, the researcher presented a written introductory letter from the University of Eastern Africa, Baraton administration so as to be allowed to gather data for the study. The consent of the respondents was solicited through a firm promise of confidentiality and anonymity. The researcher ensured to inform all respondents of the purpose of the study and also explain that the results of the study would be for academic purposes only.

Credit was be given duly to scholars whose academic works is cited during the literature review in order to avoid plagiarism.

CHAPTER FOUR

PRESENTATION OF FINDINGS, ANALYSIS AND INTERPRETATION

This section deals with the analysis and interpretation of data collected to highlight responses from respondents. Findings are based on data collected through the use of questionnaires. The section is divided into sub-headings to throw light on questions asked on the field and in relation with the objectives of the research. The findings and analyses of data collected are presented in two part. First the interpretation of the Conventional collected data and then the Islamic collected data for a clear and meaningful comparison of their effect on SMEs performance. The number of respondents was looking at 150 respondents (entrepreneurs) from both Islamic and conventional part which gives us a total of 300 respondents. From 350 questionnaires administered, 300 returned back fully responded questionnaires. After data collection, the researcher used descriptive statistics, T-test and linear regression to analyze the obtained data. From the results, it was found out that Conventional banking products tend to have a more significant effect on SMEs performance. It was concluded that Conventional banking product have a more significant effect on SMEs financial performance. When looking at the specific measures of performance against the various products. Conventional banking product have a more significant effect on SMEs financial performance. Also, when looking at the performance index with respect of the utilization of each products Conventional banking product have a more significant effect on SMEs financial performance. When looking at the overall performance of the SMEs against each products we realise There is a significant difference between the perceived effect of the following: a) overdraft (Tawarruq), b) term loan (Qardhulhasan), c) financial leasing (Ijara), d) savings account (Islamic savings, and e) loan purchase order (Murabaha).

The utilization of Conventional banking products helped achieving the entrepreneur's personal objectives to a larger extent compared to the utilization of Islamic products. Finally, there is not a significant between the extent to with which the utilization of banking products from the conventional and Islamic banks helped in achieving the entrepreneur's personal objectives.

Socio-economic Profile of Respondents

The tables below combine the descriptive statistics of the gender of the respondents; the type of business ownership; the natures of the various businesses and the business location, level of education, age of business and number of employees. For both Conventional and Islamic banking products user, for a clear comparison to be easily made.

Table 1 reveals that 91.3% of the 150 conventional banking respondents are males against only 50.7% males from the Islamic finance respondents this shows that majority of the entrepreneurs form both conventional and Islamic banking are male with a more balanced percentage in the entrepreneurs using Islamic banking services.

Concerning the business ownership, majority of SMEs using conventional and Islamic banking are sole proprietorships with the conventional having slightly higher percentage than the Islamic. This implies that most entrepreneurs in the study do not have to share profits with any other owner than themselves. They also have the freedom to make and implement their decision which directly affect the business. In other words, the majority of the SMEs involved in the study have the capacity to perform faster.

For the partnerships, the Islamic financed businesses have 36% while the conventional ones have only 15.3%. This implies that Islamic financed businesses have the capacity to raise high amount of funds but present more risk in the sense that partnership is based on trust.

For the limited liability, the conventional financed businesses have 19.3% while the Islamic ones have 14%. This implies that Conventional financed businesses are legally more structured, profitable and present less risk.

Table 1

Socio-economic Profile of the Respondents.

	Conventional		Islamic	
Gender of respondents	Frequency	Percent	frequency	percent
Male	137	91.3	76	50.7
Female	13	8.7	74	49.3
Total	150	100%	150	100%
Business ownership				
sole proprietorship	98	65.3	75	50
Partenership	23	15.3	54	36
limited liability company	29	19.3	21	14
Total	150	100%	150	100%
Nature of business				
Service	93	62	49	32.7
Manufacturing	8	5.3	17	11.3
Trade	49	32.7	84	56
Total	150	100%	150	100%
Business location				
central business district	140	93.3	44	20.3
off central business district	10	6.7	106	70.7
Total	150	100%	150	100%
Level of education of entrepreneur				
Primary	5	3.3	12	8
Secondary	19	12.7	51	34
Diploma	42	28	32	21.3
Undergraduate	52	34.7	44	29.3
Postgraduate	32	21.3	11	7.3
Total	150	100%	150	100%
Age of the business				
1 to 5 years	141	94	124	82.7
5 to 10 years	9	6	26	17.3
Total	150	100%	150	100%
Number of employees				
1 to 10	120	80	119	79
10 to 20	25	16.7	18	12
20 to 30	5	3.3	9	6
Total	150	100%	150	100%

Concerning the nature of the business, 62% of the conventional financed businesses are services against 32.7% of the Islamic financed businesses, 11.3% of the Islamic financed businesses are manufacturing businesses against 5.3% of the conventional financed businesses and 56% of the Islamic financed businesses are trade businesses against only 32% conventional financed businesses.

Looking at the business location, 93% of the conventional financed businesses are located in the central business district against only 20.3% of the Islamic financed businesses, while 70.7% of the Islamic financed businesses are located off the central business district against only 6.7% of the conventional financed businesses. This implies that conventional financed businesses are likely to make more sales than Islamic financed businesses since most of the business activity is done in the central business district.

On the education level of the entrepreneur that 28%, 34.7% and 21.3% of the entrepreneurs using conventional banking products have reached respectively the diploma, undergraduate and post graduate level while21.3, 29.3% and 7.3 of the entrepreneurs using Islamic banking products have reached respectively the diploma, undergraduate and postgraduate level. This means that though majority of our respondents have enough academic resource to run a business, entrepreneurs from conventional financed businesses have a higher education level than the entrepreneurs from Islamic financed businesses. Hence, conventional financed businesses a likely to perform better than the Islamic ones.

For the age of the businesses, the table shows that 17.3% of the Islamic financed businesses are between 5 to 10 years old against only 6% of the conventional financed businesses. While 94% of the conventional financed businesses are between 1 to 5 years old against 82.7% of the Islamic financed businesses. This means that

Islamic financed businesses have better experience in business, since majority of them have been in business for 5 to 10 years.

To the level of employee, table 1 shows that 16. 7 % of the conventional financed businesses have between 10 to 20 employees against 12% of the Islamic financed businesses. While 6% of the Islamic financed businesses have between 20 to 30 employees against 3.3% of the conventional financed businesses. This means that majority of Islamic financed businesses have more employees than Conventional financed businesses.

This results imply that majority of the conventional banking product users or entrepreneurs on the level of education have a better level than the Islamic banking products users, hence more academic qualifications, while on the age of the businesses and number of employees, Islamic financed businesses tend to have more experience and a larger number of employees than the conventional businesses. We can say that from the start without involving any banking products both Conventional and Islamic financed SMEs have the qualities and capacities to perform well in various domains. (Number of employees; education level; age of business and location of business)

Table 2

Annual Sales, Profits and Borrowing (Conventional)

	annual of sales		annual profits		annual borrowings	
	Fequency	percent	frequency	Percent	ferquency	percent
0-50000	2	1.3	31	20.7	17	11.3
50000-100000	26	17.3	13	8.7	9	6
100000-200000	8	5.3	19	12.7	29	19.3
200000-300000	9	6	30	20	21	14
300000-400000	26	17.3	9	6	24	9.3
400000-500000	33	22	13	8.7	6	4
500000-600000	10	6.7	10	6.7	13	8.7
600000-750000	12	8	10	6.7	27	18
750000-1000000	3	2	7	4.7	14	9.3
above 1000000	21	14	8	5.3	17	11.3
Total	150	100%	150	100%	150	100%

Table 3

Annual Sales, Profits and Borrowing (Islamic)

	Islamic financed businesses					
	annual of sales		annual profits		annual borrowings	
Amount in KESH	fequency	percent	Frequency	percent	ferquency	percent
0-50000	8	5.3	52	34.7	77	51.3
50000-100000	23	15.3	16	10.7	5	3.3
100000-200000	18	12	25	16.7	18	12
200000-300000	19	12.7	17	11.3	6	4
300000-400000	23	15.3	9	6	11	7.3
400000-500000	20	13.3	9	6	5	3.3
500000-600000	9	6	16	10.7	11	7.3
600000-750000	10	6.7	6	4	3	2
750000-1000000	15	10	0	0	6	4
above 1000000	5	3.3	0	0	8	5.3
Total	150	100%	150	100%	150	100%

Table 2 and 3 show that on the annual sales, 8%, 2% and 14% of the conventional financed businesses make annual sale between respectively: 600,000 to 750,000; 750,000 to 1000,000 and above 1000,000; against 6.7%, 10% and 3.3% annual sales for Islamic businesses.

On the annual profits, 6.7%; 4.7% and 5.3% of the conventional businesses make profits between respectively: 600,000 to 750,000; 750,000 to 1000,000 and above 1000,000, against 4%, 0% and 0% annual profits for Islamic financed businesses.

Looking at the annual amount borrowed, 27%, 14% and 17% of the conventional financed businesses borrow between respectively: 600,000 to 750,000; 750,000 to 1000,000 and above 1000,000 , against 2%, 4%, and 5.3 annual amount borrowed from Islamic financed businesses.

This implies that conventional financial tend to make more annual sales; annual profits, and borrow more than Islamic financed businesses. Most of this factors may be explained by the findings above. The higher level of sales and profits could be explained by the fact that conventional financed businesses are better located, have a good number of workers but mostly have a better level of education to put up strategies and take decisions that positively affect the high level of sales. On the amount of borrowings, we realize than the culture of borrowing among Islamic financed businesses is still emerging and has not yet reached the pace of the conventional businesses.

Research Question 1: What are the conventional and Islamic banking products most commonly utilized by SMEs in Kisumu?

The tables below answer the first research question, asking, what are the conventional and Islamic banking products most commonly used by SMEs in Kisumu?

Table 4

Frequency of Utilization for Conventional Banking Products

	Mean
Overdraft	1.24
Term loans	2.49
Working capital	1.74
Financial leasing	1.94
Loan purchase order	1.67
Savings accounts	4.67
Import clearing facility	1.26
Total mean	2.144

Table 5

Frequency of Utilization for Islamic Banking Products

	Mean
Wadia	1.27
Murabaha	1.93
Musharaka	1.87
Mudarabah	1.38
Ijara	1.83
Quard-hul-hassan	3.00
islamic savings	4.19
tawarruq (overdraft)	1.51
Salam (agri-based financing)	1.44
Istina (project financing)	2.11
Total mean	2.053

Table 4 and 5 show that the conventional products which are frequently used with a mean of 4.67 are the savings accounts, followed by the term loans, working capital, financial leasing and loan purchase order which are rarely used with respective means of 2.29; 1.74; 1.94 and 1.67, while overdraft with import clearing facility products are practically never used with respective means of 1.24 and 1.26 , and the Islamic products which are occasionally used with a mean of 3.00 are the Quard-hul-hasan, followed by the Islamic savings which are used sometimes with a mean of 4.19. Murabaha, Musharaka, Ijara, Tawarruq, and Istina with respective means of: 1.93; 1.87; 1.83; 1.51; and 2.11 are rarely used while Wadia, Mudaraba, and Salam, are never used.

Looking at the total mean of both conventional and Islamic banking products, we realize that the conventional banking products are more frequently used with a total mean of 2.144 than the Islamic banking products which have a total mean of 2.053. This must be due to the fact that most entrepreneurs are not aware of Islamic banking, since it is a still new in Kenya. Most of them are still attached or used to the conventional system .There is also the misconception that Islamic banking is made only for the Muslim community.

Table 6

Purpose of Utilization of Bank Product(S) (Conventional and Islamic Products)

	conventional products	Islamic products
	Means	Means
purcahase asset	2.52	2.06
Saved	3.20	3.75
business expension	2.61	2.47
used as working capital	2.52	2.18
started another business	1.95	1.96
debt settlement	1.81	1.68
sourcing of raw material	1.17	1.19
Total mean	2.254	2.184

Source: author

Table 6 reveals that for conventional banking entrepreneurs, using bank products for debt settlement and start another business is of a low importance with respective means of 1.81 and 1.95. Also, purchasing asset, business expansion and using bank products as working capital is slightly important to entrepreneurs with respective means of 2.52; 2.61 and 2.52, while is of no importance at all to entrepreneurs the use of bank products for sourcing raw material with a mean of 1.17. While, for Islamic banking entrepreneurs, using bank products for sourcing raw material is of no importance to entrepreneurs with a means of 1.19. Also, purchasing asset, business expansion and using bank products as working capital, start another business and settle debts is of low importance to entrepreneurs with respective means of 2.06; 2.47; 2.18; 1.96; and 1.68, while is of neutral importance to entrepreneurs the use of bank products for savings with a mean of 3.75.

Most conventional banking products users or entrepreneurs use bank products as business expansion, asset purchasing and working capital while Islamic banking products users mostly save and source inventory or raw materials. This surely influence performance of various SMEs in the sense that conventional financed SMEs will perform better than Islamic financed businesses.

Table 7

Reason and Level of Importance for the Choice of Utilizing the Product(s)

(Conventional Banking Products)

Conventional products	
	Mean
low risk investment	1.53
restriction on profit making	1.39
terms and conditions	2.59
in accordance with sharia law neutral	4.01
improve cash-flow neutral	3.03
Ethical standard	3.23
collateral settings	1.89
absence of interest rate or riba	2.56
bank-customer relationship	1.93
profit and risk sharing principles	1.61
principles on profit making no	1.03
procedural convenience no	1.33

Table 8

Reason and Level of Importance for the Choice of Utilizing the Product(s) (Islamic Banking Products)

Islamic products	
	Mean
Low risk investment	3.60
no restriction on profit making	1.76
terms and conditions	3.37
approval levels	3.28
improve cash-flow	4.23
Adequacy	4.41
collateral policy	2.62
absence of interest rate	1.07
bank-customer relationship	1.80
profit and risk sharing principles	1.06
principles on profit making	1.06
procedural convenience	2.08

Tables 7 and 8 show that for conventional banking products, low risk investment, good terms and condition, approval levels, improvement of cash-flow and adequacy of the products with respective means of 3.6; 3.37; 3.28; 4.23 and 4.4; are just important (neutral) reasons for going for bank products. Also, no restriction on profit taking, bank customer relationship and procedural convenience with respective means of 1.76; 1.80; 2.08 are slightly important reasons for going for bank products. While Table B shows that low risk investment, collateral settings, bank-customers relationship and profit and risk sharing principles with respective means of 1.53; 189; 1.93 and 1.61; have low importance as reasons for going for bank products. Also, terms and conditions, ethical standard and absence of Riba with respective means of 2.59; 3.23; 2.56 are slightly important reasons for going for bank products and concordance with sharia low and improvement of cash flow with respective means of 4.01 and 3.03 have neutral importance while procedural convenience, principle on making profit and restriction on making.

Table 9

Constraints in Taking Bank Product(s)

Constraints	conventional Means	Islamic Means
high risk of default	2.51	1.24
high risk of losing collateral	2.04	1.23
prioritizing inflows to settle debts	1.65	1.50
cumbersome procedures	1.49	2.27
inadequate terms and conditions	1.39	2.41

Looking at table 9, we observe that conventional banking entrepreneurs do not consider cumbersome procedures with a mean 1.49 of and inadequate terms and conditions for a product with a mean of 1.39 as constrains when applying for a financial product. Also, constrains like high cost of capital; high risk of losing collateral and prioritizing inflow to settle debt with respective means of 2.39; 2.04 and 1.65 are perceived as not serious problems when going for a bank product while high risk of default with a mean of 2.51 is perceived as a less serious problem. while Islamic banking entrepreneurs do not consider high risk of default and risk of loss with respective a mean 1.24 and 1.23 as constrains, while high cost of capital; limited opportunities for investments, cumbersome procedures and inadequate terms and conditions with respective means of 1.76; 1.50; 2.27 and 2.41 are perceived as not serious problems when going for a bank products.

Tis implies that conventional financed SMEs encounter more challenges in utilizing banking products that Islamic financed SMEs. This shows that Islamic banking products, though not well known and frequently used, present less risk, than conventional products

Research question 2. Is there a significant difference in the effect of conventional and Islamic banking products on SMEs financial performance?

In the tables below, the effect of each conventional and Islamic product was traced to each financial measure performance using the means.

Table 10

The Effect of Each Conventional Products Traced to Each Financial Measure of Performance (Conventional).

Products	Increase in sales	Increase in stock level	Increase in retained earnings	Increase in profitability	Total means
Overdraft	3.33	4.58	4.75	4.92	4.39
Working capital	2.02	2.90	2.67	2.79	2.60
Term loan	3.31	3.13	3.40	3.91	3.44
Import clearing facility	2.38	4.38	3.77	4.54	3.77
Financial leasing	3.42	3.51	3.81	3.98	3.68
Savings	3.84	3.87	3.55	4.17	3.86
Loan purchase order	3.27	3.00	3.96	3.35	3.39

Table 11

The Effect of Each Conventional Products Traced to Each Financial Measure of Performance (Islamic)

Products	Increase in sales	Increase in stock level	Increase in retained earnings	Increase in profitability	Total means
Murabaha	3.82	3.87	3.91	4.25	3.96
Mudarabah	1.86	3.24	.854	3.57	2.38
Ijarah	4.28	3.08	3.68	3.55	3.65
Quard-hul-hassan	2.51	3.20	3.30	3.30	3.08
Savings	3.89	3.83	4.14	4.12	4.00
Tawarruq	3.44	3.16	4.38	3.74	3.68
Salam	2.84	3.54	3.00	3.21	3.15
Musharaka	4.30	4.37	4.67	4.65	4.48
Istina	3.04	3.40	3.42	3.94	3.45

Tables 10 and 11, show that Overdraft product has a major effect on the increase in profitability; increase in retained earnings and increase in stock level with respective means of: 4.92, 4.75, 4.58 but a neutral effect on sales.

Working capital product has a neutral effect on the increase in profitability; increase in retained earnings and increase in stock level with respective means of 2.79, 2.67, 2.90, 2.02 but a minor effect on Sales.

Term loan product has a major effect on profitability and a neutral effect on increase in retained earnings, increase in stock level and sales with respective means of: 3.91, 3.40, 3.13, and 3.31.

Import clearing facility products have a major effect on profitability of SMEs with a means of 4.54, a moderate effect on increase in retained earnings and increase in stock level with respective means of 3.77 and 4.38, while a minor effect on sales.

Financial leasing product has a moderate effect on profitability, retained earnings, stock level, and sales with respective means of: 3.98, 3.81, 3.51, and 3.42.

Savings account product has a moderate effect on profitability, retained earnings, stock level, and sales with respective means of: 4.17, 3.55, 3.87 and 3.84. Loan purchase order product has a moderate effect on profitability, retained earnings, stock level, and sales with respective means of: 3.35, 3.96, 3.00 and 3.27.

Table B shows that Murabaha has a moderate effect on the increase in profitability; increase in retained earnings and increase in stock level with respective means of: 4.25, 3.91, 3.87 and 3.82.

Mudarabah has a moderate effect on increase in profitability with a mean of 3.57; no effect on increase in retained earnings; a neutral effect on increase in stock level and a minor effect on sales with respective means of: .854, 3.24, and 1.86.

Ijarah has a moderate effect on increase in profitability; increase in retained earnings and sales with respective means of 3.55, 3.68 and 4.28, while having a neutral effect on increase in stock level with a mean of 3.08.

Quard-hul-hassan and Salam products have a neutral effect on all performance category of the business. Also, savings account and Tawarruq products have a moderate effect on all categories of performance of business.

Musharaka has a major effect on both increase in profitability and increase in retained earnings with respective means of: 4.65 and 4.67 but a moderate effect on increase in stock level and sales with respective means of: 4.37 and 4.30.

Istina has a moderate effect on the increase in profitability with a mean of 3.94, while having a neutral effect on increase in retained earnings, increase in stock level and increase in sales with respective means of: 3.42, 3.40 and 4.04.

Comparing the performance of both conventional and Islamic banking products on SMEs performance, we realize that the Islamic banking product Musharaka has the highest mean of 4.48 compared to the conventional banking product overdraft which has a mean of 4.39, and also overdraft and import clearing facility have a major impact on performances, particularly in increase in retained earnings, stock level and profitability.

This clearly implies that looking at individual products traced to each measure of performance, Islamic banking product s have a more significant effect on SMEs performance than Conventional banking products, but more conventional products have a major effect on performance. Musharaka's highest major effect is clearly due to its profit and risk characteristic which are very attractive to customers. Islamic banking product users, really consider low risk investment and feel Musharaka is very adequate for raising capital and efficiently run SMEs. Concerning the conventional banking products, overdraft and import clearing facility, entrepreneurs utilizing conventional banking products, find it easy to raise capital from an overdraft which actually allows one to withdraw money even when the account is overdrawn. The import clearing facility also really help in importing stock or raw material in a more effective way since the bank is implicated in as a guarantor in the transaction.

Comparison of Each Products with Similar Financial Structure

The tables below, show a comparison for Conventional and Islamic banking products which have similar financial structure and their impact on SMEs various performance. These comparison gives an insight on the effect that each conventional and Islamic banking products have on each measure of performance: increase in sales, stock level, retained earnings and profitability.

Table 12

Comparison of Overdraft (Tawarruq)

	Type of respondents	Mean	P-value
increase in sales	Conventional	3.33	.766
	Islamic	3.44	
increase in stock level	Conventional	4.58	000
	Islamic	3.16	
increase in retained earnings	Conventional	4.75	184
	Islamic	4.38	
increase in profitability	Conventional	4.92	.010
	Islamic	3.74	

The conventional product Overdraft according to Table 16 have a significant effect on the increase in stock level and increase in profitability of SMEs with respective means of 4.58 and 4.92, compared to the Islamic product Tawarruq which thought very different from Overdraft has the same financial structure.

Table 13

Comparison of Term Loan (Qardhulhasan)

	Type of respondents	Mean	p-value	t
increase in sales	Conventional	3.31	.002	3.136
	Islamic	2.51		
increase in stock level	Conventional	3.13	.727	-.350
	Islamic	3.20		
increase in retained earnings	Conventional	3.40	.619	.498
	Islamic	3.30		
increase in profitability	Conventional	3.91	.005	2.824
	Islamic	3.30		

The Conventional product Term loan according to table 17 have a significant effect mostly on the increase in sales with a P- value of .002 and also, increase in profitability of SMEs with a P-value of .005 with respective means of 3.31 and 3.91, compared to the Islamic product Quard-hul-hassan which has a less significant effect on SMEs financial performance. The conventional banking product term loan has been the main conventional banking products utilized over the years, and despite the emergence of Islamic banking, this product is still highly patronized by businesses.

Table 14

Comparison of Financial Leasing (Ijara)

	Type of respondents	Mean	P-value
increase in sales	Conventional	3.42	.002
	Islamic	4.28	
increase in stock level	Conventional	3.51	.642
	Islamic	3.08	
increase in retained earnings	Conventional	3.81	.490
	Islamic	3.68	
increase in profitability	Conventional	3.98	.001
	Islamic	3.55	

The Islamic product Ijara, according to Table 18 have a significant effect on the increase in sales with a P-value of .002 with a means of 4.28, compared to the conventional product financial leasing. Nevertheless, the conventional product financial leasing has a more significant effect on increase in profitability with a mean of 3.98 and a P-value of .001, we realize that the two products are really close in term of significance, though the conventional banking product financial leasing seem to have a higher significance than Ijara, because they present similar characters aside the absence of interest rate in Ijara. Entrepreneurs prefer to stick to the traditional way of leasing than venturing in the Islamic banking product Ijara which is still not well known to the public.

Table 15

Comparison of Savings Account (Islamic Savings)

	Type of respondents	Mean	p-value	t
increase in sales	Conventional	3.84	.782	-.276
	Islamic	3.89		
increase in stock level	Conventional	3.87	.781	.278
	Islamic	3.83		
increase in retained earnings	Conventional	3.55	.000	-4.420
	Islamic	4.14		
increase in profitability	Conventional	4.17	.777	.284
	Islamic	4.12		

The Islamic product, Islamic savings account, according to Table 19 have a significant effect on the increase in retained earnings of SMEs with a means of 4.14, and a P-value of .000 compared to the conventional product Savings accounts which has a less significant mean of 3.55. Though Islamic savings account do not attract interest, the bank can reward the customer for granting the permission to the bank to use his funds. The significance of Islamic savings over conventional saving might be more attached to religious reasons than financial reasons.

Table 16

Comparison of Loan Purchase Order (Murabaha)

	Type of respondents	Mean	P value
increase in sales	Conventional	3.27	.577
	Islamic	3.82	
increase in stock level	Conventional	3.00	.003
	Islamic	3.84	
increase in retained earnings	Conventional	3.96	.744
	Islamic	3.89	
increase in profitability	Conventional	3.35	.005
	Islamic	4.23	

The Islamic product Murabaha, according to Table 20 have a significant effect on the increase in stock level and increase in profitability of SMEs with respective means of 3.84 and 4.23, compared to the conventional product Loan purchase order. This is due to the fact that Murabaha is an interest rate free product and only point out an agreed price at which the customer or entrepreneur will acquire whatever product he has ordered.

Research Question 3: What is the marginal effect of each products on the measure of performance index of SMEs with respect to the utilization of each products and on the overall measure of performance?

The tables below, 12 and 13 shows the OLS regression parameter estimates for the performance index of conventional finance products. These parameters estimates can be indicators of the marginal effect of each products on the performance index of SMEs with respect to the utilization of each products determine the statistical significance of the effect.

On the performance index, based on the marginal effect of Overdraft product, it can be noted that the utilization of overdraft has a positive coefficient of 1.132, hence a positive marginal effect on the performance index and is statistically significant with t ratio of 12.10. Also, working capital and term loan have positives respective coefficients of .073 and .039 but are statistically not significant with respective t ratios of 1.51, 1.19, with respect of the utilization of overdraft this implies that entrepreneurs find it easier to use overdraft to run their businesses than working capital or term loan.

Table 17

OLS Parameter Estimates for the Performance Index of Conventional Products.

					Conventional products			
Performance index	Constant	Overdraft	Working capital	term loan	import clearing facility	financial leasing	savings	loan purchase order
	.705	1.132	.073	.039	-.058	-.116	-.122	-.122
$MOPX_1$	*(2.91)	*(12.10)	(1.51)	(1.19)	(-1.17)	*(-3.03)	*(-2.67)	*(-2.63)
	-.280	-.924	1.224	.052	.047	-.016	.062	.064
$MOPX_2$	(-1.55)	*(-13.23)	*(34.08)	*(2.16)	(1.26)	(-.54)	(1.81)	(1.85)
	1.618	-.068	-.250	.959	-.144	-.057	-.208	-.206
$MOPX_3$	*(5.17)	(-.55)	(-.18)	*(22.83)	*(-2.25)	(-1.15)	*(-3.53)	(-.44)
	-.032	-.048	.020	.028	.937	-.018	.003	.018
$MOPX_4$	(-.26)	(-1.01)	(.80)	(1.72)	*(37.16)	(-.92)	(.144)	(.75)
	-.645	-.339	.204	-.018	-.024	1.000	.192	-.217
$MOPX_5$	(-1.85)	*(-2.52)	*(2.95)	(-.38)	(-.33)	*(18.18)	*(2.93)	*(-3.28)
	1.837	-.078	- .040	-.138	-.285	-.121	.624	-.033
$MOPX_6$	*(5.87)	(-.64)	(-.64)	*(-3.27)	*(-4.43)	*(-2.43)	*(10.60)	(-.550)
	-.180	-.474	.056	.028	-.008	-.007	.036	.958
$MOPX_7$	(-1.34)	*(-9.19)	*(2.11)	(1.54)	(-.30)	(-.339)	(1.44)	*(37.76)

Source: Author. Figures in parenthesis are t-statistics for the null hypothesis that the respective coefficient is zero. * Significance at 5%.

Nevertheless, financial leasing, savings and loan purchase order with respective negative coefficients of: -.116, -. -.122, and -.122, have a negative marginal effect on performance index and are negatively significant with respective t ratios of" -3.038, -2.673 and -2.639 of the utilization of overdraft. Import clearing facility has a negative marginal effect but is not significant.

On the performance index, based on the marginal effect of working capital loan product, it can be noted that utilization of working capital loan and term loan have respective positive coefficient of 1.224 and .052 hence a positive marginal effect on the performance index and are significant with respective t-ratios of 34.08 and 2.16. While overdraft has a negative coefficient of: -.924 and is negatively significant. On another hand, products like; Import clearing facility; savings and loan purchase order with respective coefficients of:.047, .062 and .064 have positive coefficient and have a positive marginal effect on the performance index but are not significant.

Financial leasing with a negative coefficient of -.016 is not significant with respect of the utilization of working capital loan

On the performance index, based on the effect of Term loan product, it can be noted that the utilization of term loan has a positive coefficient of .959, hence a positive marginal effect on the performance index and is significant at a t ratio of 22.832, While financial leasing, overdraft, working capital and loan purchase order with respective negative coefficients of:-.057 -.068, -.250 and -.206 are not significant with respect of the utilization of term loan. Nevertheless import clearing facility and savings with respective negative coefficients of: - .144 and -.208 are negatively significant with respect of the utilization of term loan.

On the performance index, based on the effect of Import clearing facility product, it can be noted that the utilization of import clearing facility, has positive coefficient of: .937 , hence a positive marginal effect on the performance index and is significant at t ratios superior to 1.96, While product like savings, term loan, working capital and loan purchase order with positive coefficients of.003, .028, .020 and .018 are not significant also, with respect to the utilization of import clearing facility, thought having a positive marginal effect. financial leasing and overdraft with respective coefficients of: -.018 and -.048 have negative marginal effect but are not significant.

On the performance index, based on the effect of Financial leasing product it can be noted that the utilization of financial leasing, working capital and savings have positive respective coefficients of: 1.000, .204 and .192 hence a positive marginal effect on the performance index and are statistically significant with t ratios superior to 1.96, while overdraft, working capital and loan purchase order with respective coefficients of -.339, .204 and -.217 have a negative marginal effect on performance index and are statistically significant with respect of the utilization of financial leasing. But term loan and import clearing facility products with respective coefficients of -.018 and -.024 are not significant with t ratios inferior to 1.96.

On the performance index, based on the effect of Savings account product, it can be noted that the utilization of savings account product has a positive coefficient of .624, hence a positive marginal effect on the performance index and is statistically significant with a t ratio of 10.60, while term loan , import clearing and financial leasing with respective coefficients of -.138, -.285 and -.121 are negatively significant and overdraft, working capital loan and loan purchase order with respective coefficients of -.138, -.285 and -.033 have a negative marginal effect on performance index but are statistically not significant with respect of the utilization of savings account products.

On the performance index, based on the effect of Loan purchase order product, it can be noted that the utilization of loan purchase order and working capital have respective positive coefficient of .958 and .056, have positive marginal effect on the performance index and are significant with t ratios superior to 1.96, While term loan and savings have positive marginal effect on performance index but are not significant Also, import clearing facility and financial leasing with respective coefficients of -.008 and -.007 are not significant and overdraft with a coefficient of -.474 is negatively significant, always with respect of the utilization of loan purchase order.

Table 18

OLS Parameter Estimates for the Performance Index of Islamic Products

					Islamic products					
Performance index	Constant	Murabaha	Mudarabah	Ijara	Quard-hul-hasan	Savings	Tawarruq	Salam	Musharaka	Istina
	.585	.734	-0.041	.006	.005	-.001	-.105	.279	.011	-.115
$MOPX_8$	*(2.02)	*(12.06)	(-.40)	(.08)	(.09)	(-.01)	(-1.45)	*(3.31)	(.18)	(-1.50)
	-.004	.017	.812	-.017	.085	-.016	-.039	.004	.050	-.045
$MOPX_9$	(-.02)	(.50)	*(14.71)	(-.43)	*(3.33)	(-.30)	(-.98)	(.08)	(1.51)	(-1.07)
	.359	-.130	.316	.580	-0.139	.021	-.052	-.023	.069	.044
$MOPX_{10}$	(1.76)	*(-3.02)	*(4.44)	*(11.79)	*(-4.23)	(.32)	(-1.00)	(-.392)	(1.61)	(.81)
	-.312	-.003	-.106	-.023	.744	.119	.212	-.009	.118	.081
$MMOPX_{11}$	(-1.48)	(-.07)	(-1.44)	(-.46)	*(22.03)	(1.78)	*(4.01)	(-.147)	*(2.67)	(1.46)
	1.796	.085	-.161	.166	.017	.545	.057	-.016	.218	.075
$MOPX_{12}$	*(5.91)	(1.33)	(-1.51)	*(2.25)	(.34)	*(5.63)	(.74)	(-.18)	*(3.40)	(.93)
	.532	-.049	-.040	-.048	.031	.103	.724	-.114	-.090	-.119
$MOPX_{13}$	*(2.00)	(-.87)	(-.43)	(-.75)	(.73)	(1.21)	*(10.84)	(-1.46)	(-1.60)	(-1.70)
	-.217	.138	.030	-.066	.004	.070	.128	.585	.016	-.003
$MOPX_{14}$	(-1.52)	*(4.61)	(.61)	(-1.91)	(.18)	(1.55)	*(3.55)	*(14.16)	(.54)	(-.09)
	.655	.164	.372	-.128	.020	-.264	.093	-.017	.972	.069
$MOPX_{15}$	*(2.895)	*(3.44)	*(4.71)	*(-2.34)	(.54)	*(-3.66)	(1.64)	(-.25)	*(20.38)	(1.15)
	.163	-.110	-.203	-.020	.019	.000	.080	.221	.054	1.048
$MOPX_{16}$	(.774)	*(-2.46)	*(-2.75)	(-.38)	(.55)	(-.00)	(1.51)	*(3.59)	(1.22)	*(18.84)

Source: Author. Figures in parenthesis are t-statistics for the null hypothesis that the respective coefficient is zero. * Significance at 5%

On the performance index, based on the effect of The Murabaha product it can be noted that utilization of Murabaha and Salam have positive respective coefficients of .734 and .279 hence have a positive marginal effect on the performance index and are significant, while Ijara, Quard-hul-hassan and Musharaka with respective means of .006, .005 and .011 are not significant though having a positive marginal effect on performance index. Also, Mudarabah, savings, Tawarruq and Istina, with respective coefficients of -0.04, -.001, -.105 and -.115 are not significant with negative marginal effect, with respect of the utilization of Murabaha.

On the performance index, based on the effect of Mudarabah product, it can be noted that utilization of Mudarabah and Quard-hul-hassan with respective coefficient of .812 and .085 have a positive marginal effect on the performance index and are significant with t ratios superior to 1.96, while Murabaha, Musharaka and Salam with respective coefficients of .017, .050 and .004 are not significant with t ratios less than 1.96. But savings, Istina, Tawarruq and Ijara which have respective negative coefficients of -.016 -.045, -.039 and -.017 have negative marginal effect and are not significants with respect of the utilization of Mudarabah,

On the performance index, based on the effect of Ijara, it can be noted that utilization of Ijara and Mudarabah, with respective coefficients of .580 and .316, have a positive marginal effect on the performance index and are statistically significant with t-ratios superior to 1.96 , while savings, Musharaka and Istina with coefficient of .021, .069 and .044 are not significant. Also, Murabaha and Quardhulhassan have negative respective coefficients of -.130 and -0.139 and are significant with respect of the utilization of Ijara. Only Salam and Tawarruq with negative coefficients of -.023 and -.052 are not significant with negative marginal effect.

On the performance index, based on the effect of Quard-hul- hassan it can be noted that utilization of Quard-hul-hassan, Tawarruq, and Musharaka have positive respective coefficients of: .744, .212, .118 ,hence have positive marginal effect on the performance index and are significants with t-ratios superior to 1.96. But Murabaha, Mudaraba, Ijara and Salam with negative respective coefficients of -.003, -.106 -.023 and -.009, are not significant with respect of the utilization of Quard-hul-hassan while Istina and Savings with respective coefficients of .081and .119 have positive marginal effect but are not significant.

On the performance index, based on the effect of Savings account product, it can be noted that utilization of savings account, Ijara, and Musharaka, have positive respective coefficients of .545, .166, and .218, Hence, have a positive marginal effect on the performance index and are significant with t-ratios superior to 1.96, while Murabaha, Quard-hul-hasan, Tawarruq and Istina with respective coefficient of .085, .017, .057 and .075 are not significant with a t ratios less than 1.96. Mudarabah and Salam with coefficients of -.161 and -.016 have negative marginal effect and are not significant, with respect of the utilization of savings.

On the performance index, based on the effect of Tawarruq product, it can be noted that utilization of Tawarruq has a positive coefficients of: .724, hence has a positive marginal effect on the performance index and is significant with t ratios superior than 1.96. Salam, Musharaka, Istina, Ijara, Mudaraba and Murabaha with respective coefficients of: -.114, -.090, -.119, -.048, -.040 and -.049 are negatively significant with respect of the utilization of Tawarruq, but are not significant while Quard-hul-hassan and savings with respective coefficient .031 and .103 are not significant with t-ratio less than 1.96.

On the performance index, based on the effect of Salam product, it can be noted that utilization of Salam, , Tawarruq and Murabaha have positives respective coefficients of .585,.128 and .138 hence have a positive marginal effect on the performance index and are significant with t-ratios superior to 1.96, while, Quard-hul-hasan, Savings, Musharaka and Mudaraba with respective positive coefficients of .004, .070, .016 and .030 are not significant. Also, Ijarah has a negative coefficient -.066 which is significant with respect to the utilization of Salam, while Ijara and Istina with respective coefficients of: -.066 -.003 are not significant with respect of the utilization of Salam.

On the performance index, based on the effect of Musharaka, it can be noted that utilization of Musharaka, Murabaha and Mudaraba, have positive respective coefficients of: .972, .164, and .372, hence a positive marginal effect on the performance index and are significant with t-ratios superior to 1.96, while Quard-hul-hassan, Tawarruq and Istina with respective positive coefficient of .020, .093 and .069 are not significant. Ijara and Savings with respective negative coefficients of -.128 and -.264 are significant with respect of the utilization of Musharaka while Salam with a coefficient of -.017 is not significant.

On the performance index, based on the effect of Istina, it can be noted that utilization of Istina, and Salam, have positive coefficients of: 1.048 and .221, hence a positive marginal effect on the performance index and are significant, while Quard-hul-hassan, Tawarruq and Musharaka have respective coefficients of: .019, .080 and .054 are not significant. Murabaha and Mudarabah have respective coefficients of -.110 and -.203 and are negatively significant with respect of the utilization of Istina and Ijarah has a coefficient of -.020 but is not significant. It is also good to notice that Savings has a null coefficient, hence no effect on the performance index of the SMEs and is not significant, always with respect of the utilization of Istina.

Comparing the highest coefficients in both table 12 and 13, we realize that the conventional product working capital loan with 1.224 compared to Istina which has a coefficient of 1.048 has a higher marginal effect on performance index. Also, looking at the significance, the conventional product loan purchase order is statistically the most significant with a t-ratio of 37.760 while the Islamic product Quard-hul-hassan has a t-ratio of 22.033.Therefore, it can be said that conventional banking products have a higher significance and marginal effect compared to Islamic banking products. They have higher effect on performance index.

This can be explained on the basis that working capital loan gives room for entrepreneurs to raise needed funds in a short period of time and make repayment on installment with interest for the day today activities to be made. Also, loan purchase order is a products that allow the entrepreneur to purchase a certain asset through the bank at a fee and also based on interest. This method gives a more flexible mean to SMEs to supply themselves and acquire assets, hence expend.

Research Question 4: Is there a significant difference between Conventional and Islamic banking products in their marginal effect on the overall performance of SMEs?

The two tables below, Table 14 and table 15 indicate the measure of performance with regard to utilization of all Islamic and conventional and the marginal effect of each to the overall performance. The coefficient of each product represent the marginal effect of each products on the overall performance index. The values in bracket are the T-ratios ratios indicate the overall significance of the equation.

Table 19

OLS Parameter estimates for the overall performance measure for conventional banking product(s)

	C_0	X_1	X_2	X_3	X_4	X_5	X_6	X_7	F	R^2
MOP_{Xi}	.432 *(3.838)	-.114 *(-2.620)	.184 *(8.224)	.136 *(8.994)	.066 *(2.875)	.095 *(5.332)	.084 *(3.956)	.092 *(4.287)	46.432	.696

Source: Author Figures in parenthesis are t-statistics for the null hypothesis that the respective coefficient is zero. * Significance at 5%

Table 20: *OLS Parameter estimates for the overall performance measure for Islamic banking product (s).*

	B_0	X_8	X_9	X_{10}	X_{11}	X_{12}	X_{13}	X_{14}	X_{15}	X_{16}	F	R^2
MOP_{Xi}	.395 *(6.872)	.094 *(7.763)	.109 *(5.426)	.050 *(3.600)	.087 *(9.428)	.064 *(3.499)	.122 *(8.447)	.101 *(6.033)	.158 *(13.017)	.115 *(7.573)	95.556	.860

Source: Author Figures in parenthesis are t-statistics for the null hypothesis that the respective coefficient is zero. * Significance at 5%

All the coefficients in the Islamic equation are positive and statistically significant. While for the conventional, all the coefficients of the utilization of the product are positive, except the Overdraft product and are statistically significant. Looking at the Islamic products, Musharaka has the highest marginal effect on the overall performance, followed by Tawarruq and Istina and Mudaraba. The lowest is Ijara. The R^2 of .860 implies that 86% of the variations in the MOP index are explained by the Islamic products utilized by SMEs. For the conventional products, Working capital has the highest marginal effect on the overall performance followed by Savings and financial leasing. While the lowest is Import clearing facility.

Comparing the highest marginal effect and statistical significance form both tables, we can say that the conventional banking product, working capital loan has the highest coefficient of .184 but a less statistically significant effect on the overall MOP compared to the Islamic product Musharaka which though has a lesser coefficient of .158, has the most statistically significant effect on the overall MOP.

Hence we can say that the Islamic banking Musharaka is a core product when it comes to the effect Islamic products affect SMEs performance due to its undeniable principles of profit and risk sharing. On the other hand, conventional finance product working capital loan with the highest coefficient has the highest marginal effect on performance. This can be explain on the basis that being small businesses, SMEs generally encounter problems of liquidity.in this case, working capital loan becomes a very adequate product which supply SMEs with enough cash to run their day to day activities.

Research question 4: How has the utilization of conventional banking products and Islamic banking products, affected the achievement the entrepreneur's personal objectives?

Conventional Banking

Table 21

Entrepreneurs Objectives and Bank Products Utilization

	Mean
Self-employment	3.08
major changes in personal circumstances	2.94
a desire to pursue an interest or career	3.38
better use of skills and abilities	3.47
need a more flexible and convenient work schedule	3.26
need for greater independence	4.00
to make suitable profit	2.11
welfare of family	3.52
need to contribute to humanitarian cause	1.86

Table 21 shows that the utilization of banking products from the bank helped to a very large extent, entrepreneurs who have for personal objectives: the need for greater independence and Welfare of family with respective means of 4.00 and 3.52. The table also shows that the utilization of banking products from the bank helped to a large extent, entrepreneurs who have for personal objective: Self-employment, overcome major change in personal circumstance, a desire to pursue an interest or career, better use of skills and ability, need for a more flexible or convenient schedule, with respective means of: 3.08, 2.94, 3.38, 3.47, 3.28. Finally, the utilization of banking products from the bank helped to a moderate extent, entrepreneurs who have for personal objectives, making suitable profits and contribute to humanitarian cause with respective means of: 2.11, 1.86.

Islamic Banking

Table 22

Entrepreneurs Objectives and Bank Products Utilization

	Mean
self employment	3.43
major changes in personal circumstances	3.19
a desire to pursue an interest or career	2.76
better use of skills and abilities	3.07
need a more flexible and convenient work schedule	2.87
need for greater independence	2.77
to make suitable profit	2.49
welfare of family	2.73
need to contribute to humanitarian cause	2.94

` Table 22 shows that the utilization of Islamic banking products from the bank helped to a large extent, entrepreneurs to achieve the totality of the objectives listed above. This means that Islamic banking products help significantly in achieving entrepreneur's objectives.

Looking at the highest means of both tables 21 and 22, both conventional and Islamic banking products contribute significantly in helping entrepreneurs achieve their personal objectives but conventional banking products with the highest mean of 4.00 helps entrepreneurs more significantly in achieving their personal objectives compared to Islamic banking products which has a highest mean of 3.43.

Research question 4. Is there a significant difference between the extent with which the utilization of banking products from the conventional and Islamic banks helped in achieving the entrepreneur's personal objectives?

Table 23

Comparison of Achievement of Entrepreneur's Objective(s)

	TYPE OF RESPONDENT	Mean	P-value
major changes in personal circumstances	Conventional	2.94	.290
	Islamic	3.19	
a desire to pursue an interest or career	Conventional	3.38	.002
	Islamic	2.76	
need a more flexible and convenient work schedule	Conventional	3.26	.141
	Islamic	2.87	
need for greater independence	Conventional	4.00	.003
	Islamic	2.77	
to make suitable profit	Conventional	2.11	.229
	Islamic	2.49	
need to contribute to humanitarian cause	Conventional	1.86	.033
	Islamic	2.94	

Conventional banking products according to table 23, have helped entrepreneurs who have for personal objective the desire to pursue an interest or career to reach their goal, more than the Islamic entrepreneurs.

Concerning the need for greater independence, conventional products, also had a more significant effect on entrepreneurs who have for personal objectives, greater independence. Indeed, conventional banking products unlike Islamic banking products promotes profits earning and have less limitations in business investment than Islamic banking. This allows entrepreneurs to raise quickly necessary capital and put up new businesses.

Nevertheless, looking at the need to contribute to humanitarian cause, Islamic banking products have a more significant impact or effect on entrepreneurs. This is due to the fact that Islam promotes principles of fairness and equity but above all helping the needy.

Table 24

Comparison of Achievement of Entrepreneur's Objective(s)

	TYPE OF RESPONDENT	Mean	P-value
Self-employment	Conventional	3.08	.037
	Islamic	3.43	
better use of skills and abilities	Conventional	3.47	.032
	Islamic	3.07	
welfare of family	Conventional	3.52	.002
	Islamic	2.73	

For entrepreneurs who have for personal objectives self-employment, table 24 shows that Islamic banking products tend to have a more significant effect than the conventional product, while conventional products tend to have a significant effect on entrepreneurs who have for objectives; better use of skills and ability and welfare of family.

CHAPTER FIVE

SUMMARY CONCLUSION AND RECOMMENDATIONS

Summary of the Main Findings

The researcher conducted the study in Kisumu, Kenya. The research conducted was about the effects of conventional and Islamic banking products on the performance of small and medium enterprises in Kisumu, Kenya**,** considering that most SMEs still struggle to raise capital to finance themselves and also that most literature do not focus on the differences on the performances of SMEs financed by Conventional and Islamic banking products

The study used descriptive and cross sectional survey research design. Furthermore, the researcher employed purposive sampling technique to address both Islamic banking product users and conventional banking product users. From 350 questionnaires administered, 300 returned back fully responded questionnaires. After data collection, the researcher used descriptive statistics, T-test and linear regression to analyze the obtained data.

1. In an attempt to know the conventional and Islamic banking products most commonly utilized by SMEs, we realized that the conventional banking products are more frequently used with a total mean of 2.144 than the Islamic banking products which have a total mean of 2.053.
2. In an attempt to find out the effect of conventional and Islamic banking products on SMEs financial performance, we realize that overdraft and import clearing facility are the product that have a major effect on SMEs performance, particularly: Increase in retained earnings, increase in stock level and profitability. This phenomenon can be explain through the fact that most

entrepreneurs prefer to finance their business through short term financial products because it allows them to raise funds easily.

For the Islamic products, only Musharaka has a major effect on SMEs performance particularly: increase in retained earnings and profitability. This is due to the fact that Musharaka is a safe an easy to generate funds for entrepreneurs, because they are able to share risk and also profits. This explains the major effect of that product on profitability and retained earnings. In total, on the effect of conventional and Islamic banking products, on SMEs various performance measure, we realize say that both Conventional and Islamic banking products have significant effect on SMEs performance. Nevertheless, comparing the performance of both conventional and Islamic banking products on SMEs performance, we realize that though the Islamic banking product Musharaka has the highest mean of 4.48 compared to the conventional banking product overdraft which has a mean of 4.39, more conventional products have a major effect on SMEs' financial performance than Islamic products this clearly implies that looking at individual products traced to each measure of performance, conventional products have a more significant effect on SMEs performance than Islamic banking products .

On the significant difference between the effect of the following conventional and Islamic banking products on financial performance of SMEs: a) overdraft (tawarruq), b) term loan (qardhulhasan), c) financial leasing (ijara), d) savings account (Islamic savings, and e) loan purchase order (murabaha), we realize that conventional banking products in most cases are perceived to have a more significant effect on performance of SMEs than Islamic products.

3. Concerning the marginal effect of Conventional banking products and Islamic banking products, on SMEs measure of performance index with respect of the utilization of each product. We realize that for the conventional banking products, most products have a positive impact on the performance index of SMEs and the most significant with the highest t-ratio of (37.760) is loan purchase order, while the product with lowest t-ratio of (10.6) is Savings. This implies that entrepreneurs being more concerned with making purchases and supplying their business activities prefer loan purchase order than using their savings. For the Islamic banking products, we also realize that they all have a positive impact on the performance index of SMEs and the most significant product with the highest t-ratio of (22.033) is Quard-hul-hassan while the product with the least significant effect is Islamic savings with a T-ratio of (5.636). This implies that Islamic banking products users, are resort mostly to Quard-hul-hassan which is a form of interest-free long term loan, because of the absence of interest. This product appears to be suitable in running business rather than utilizing savings.

   We also realize that the conventional banking product working capitalwith a coefficient of 1.224 compared to the Islamic banking product Istina which has a coefficient 1.048 has a superior marginal effect. Comparing the both products in terms of marginal effects and significance, it is clear that conventional banking products have a better effect and significance on performance than Islamic banking products. But it is also good to underline that both products have considerable positive and significant effects on the performance index.

4. On the effect of conventional banking products and Islamic finance on the overall performance measure of SMEs, we observed in the regression analysis that for Islamic banking products, the most significant product thought all of them have a significant effect on the overall performance measure, is Musharaka with a t-ratio of (13.017) while the least significant is savings with a t-ratio of (3.499). This implies that when it comes to the overall performance of SMEs, (increase in sale, increase in stock level, increase in retained earnings and increase in profitability) Islamic users tend to use Musharaka which is profit generating and has a low risk rate because of the principle of risk sharing and using less savings to run business activities. In the regression analysis for conventional financial products, the most significant product is working capital loan, with a T-ratio of (8.224) while overdraft has a significant negative effect of (-2.620) on the overall performance of the SMEs. This negative effect is due to the fact that overdraft even though a quick adequate mean to finance a business is not suitable to SMEs in the sense that its premier purpose is not to fund the day to day activities of a business the more appropriate product would be working capital loan.

    Comparing the highest marginal effect and statistical significance form both tables, we can say that the conventional banking product, working capital loan has the highest coefficient of .184 but a less statistically significant effect on the overall MOP compared to the Islamic product Musharaka which though has a lesser coefficient of .158, has the most statistically significant effect on the overall MOP. Hence we can say that the Islamic banking Musharaka is a core product when it comes to the effect Islamic products affect SMEs performance due to its undeniable principles of profit and risk sharing. On the other hand, conventional finance product working capital loan with the highest coefficient has the highest marginal effect on performance. This can be explain on the basis that being small businesses, SMEs generally encounter problems of liquidity.in this case, working capital loan becomes a very adequate product which supply SMEs with enough cash to run their day to day activities.

5. Concerning how the utilization of conventional and Islamic banking products affected the achievement of the entrepreneur's personal objectives, the highest mean for the personal objectives of conventional users is 4.00 for entrepreneurs who have for objectives the need for greater independence and the highest mean for Islamic banking products users is 3.43 for entrepreneurs that have for personal objectives self-employment. Also, looking at the various means from both Islamic and conventional banking products users, we realize that conventional banking products have a significant influence or impact in helping its users achieve their personal objectives than Islamic user who nevertheless show a significant effect of Islamic banking products on their personal objectives.
6. Looking at the significant difference between the extent with which the utilization of banking products from the conventional and Islamic banking helped in achieving the entrepreneur's personal objectives, we can say that there is no significant difference between the extents to which the utilization of banking products from the Islamic and conventional helped in achieving entrepreneur's objectives. Nevertheless we observe that conventional products help achieve personal objective to a better extent than Islamic products

recognizing the fact that Islamic products have a significant effect in helping its user meet their personal objectives.

Conclusions

1. Conventional banking products, are more frequently utilized than Islamic banking products. This phenomenon is normally due to the fact that the conventional banking product has been and still is the main source of banking for more businesses compared to Islamic banking products. Entrepreneurs are still used to the main source of finance (conventional banking) but are also not fully aware of the various Islamic banking products on the market.
2. a) There is a significant difference in the perceived effect of conventional and Islamic banking products on SMEs financial performance. Conventional banking products have a more significant effect on SMEs financial performance. When looking at the specific measures of performance against the various products. Conventional banking product have a more significant effect on SMEs financial performance. Indeed, conventional banking products are more frequently used than Islamic banking products but there is also the fact that conventional banking products are the products which have been used since banks have been operating. It is still difficult for entrepreneurs to shift and embrace a new finance system all together. There is also the fact that conventional banking products are more market sensitive due to interest rate fluctuation and financial markets operations.

b) There is a significant difference between the effect of the following: a) overdraft (Tawarruq), b) term loan (Qardhulhasan), c) financial leasing

(Ijara), d) savings account (Islamic savings, and e) loan purchase order (Murabaha). Conventional products overdraft, term loan and financial leasing seem to have a more significant effect on performance than they respective counterpart Tawarruq, Quard-hul-hassan and Ijara while Islamic savings and Murabaha have a more significant effects on SMEs's financial performance than their respective counterpart: savings account and loan purchase order.

3. There a significant difference between Conventional and Islamic banking products in their marginal effect on performance index. Conventional banking products have a better effect and significance on performance than Islamic banking products. But it is also good to underline that both products have considerable positive and significant effects on the performance index. This is due to the fact that Islamic banking is still new though presenting great opportunities to SMEs, hasn't reached the pace of conventional banking which is still the banking system to which majority of people is still used to.
4. There a significant difference between Conventional and Islamic banking products in their marginal effect on the overall performance of SMEs. Indeed, the conventional product Working capital loan has the highest marginal effect of .184 on the overall performance of SMEs against the Islamic banking products Musharaka .158 which nevertheless is statistically more significant than working capital. It is important to note that these two products are frequently used by entrepreneurs. According to table 4 and 5, the Islamic banking product Musharaka is more frequently

used than working capital. This explains the higher statistical significance of musharaka over working capital loan.

5. The utilization of Conventional banking products helped achieving the entrepreneur’s personal objectives more significantly compared to the utilization of Islamic products. Nevertheless, it is important to insist on the fact that Islamic banking products also significantly to the achievement of personal objectives of entrepreneurs.
6. There is not a difference significant between the extents to with which the utilization of banking products from the conventional and Islamic banks helped in achieving the entrepreneur’s personal objectives. Nevertheless, conventional products tend to be better at meeting personal objectives of entrepreneurs.

   The major or significant difference do not occur because mostly Islamic entrepreneurs may not attach financial or market value to their personal satisfaction because Islamic finance is already consistent with their faith and is mostly not market sensitive, while, conventional banking products users attach more financial or market value to personal satisfaction, taking account of the few restrictions on investment.

Recommendations

Islamic finance though presenting more advantages and opportunities for SMEs is not fully grown and meet many challenges that need to be addressed for it to have a better impact or effect on the performance of SMEs.

1. Financial institutions offering Islamic banking fully or partially need to create more awareness about the principles, advantages and opportunities of Islamic finance

2. More strategies need to be put in place by Islamic finance institutions to penetrate also the non-Muslim community and give a better insight to people about the various advantages and opportunities Islamic finance may have for SMEs and businesses in general.

Recommendations for Further Studies

1. A study could be done on the effect of Islamic finance products on the welfare of non-Muslim community in Tanzania.
2. The determinants of financial risk faced by Islamic banking in Kenya
3. The role of microfinance in alleviating poverty among women groups in Kenya.

REFERENCES

Abas, S. (2013). *Islamic Banking and Investment Financing: A Case Of Islamic Banking In Kenya*, University of Nairobi.

Abduallah, A., Qaiser, R., Yasser, & Harry, E. (2014). *Comparison between Islamic and Conventional Banking: Evidence from Malaysia.* International Journal of Islamic Banking & Finance, ISSN: 2220-8291, Vol. 4, Issue 1.

Abul, H. (2009).*The Global Financial Crisis and Islamic Banking.* The Islamic Foundation, UK

Agao, E. A. (2014). *The effect of macroeconomic variables on the mortgage uptake for mortgage industry in Kenya* (Doctoral dissertation, School of Business, University of Nairobi).

Ahmed, H. (2002). *Financing micro enterprises: an analytical study of Islamic microfinance institutions*. Islamic Economic Studies, 9(2), 27-64.

Alex, M. (2011), *Newsline. The Professional journal of KASNEB*, Issue no.1 p.24

Ali, A. (2016). *Comparison of Musharakah and conventional financing with respect to risk mitigation in SME financing*.

Amir, A. (2011). *The Difference Between Islamic Banking Financing and Conventional Banking Loans.* Islamic Bankers, Ressource center. Retrieved from https://islamicbankers.me

Arora, S., & Ferrand, D. (2007). *Kenya: Meeting the challenge of creating an inclusive financial sector.* Background paper for the DFID and HM Treasury Financial Inclusion Conference, London (19 June 2007).

Asian Development Bank, (2000). *Finance for the Poor.* Microfinance Development Strategy.

Asim, E., & Muhammad, S.(2015). *Bay Salam: A Proposed Model for Shari'ah Compliant Agriculture Financing*. Business & Economic Review: Vol. 7, Issue 1: 2015 pp. 67-80.

Ausaf, A. (1993), *'Contemporary practices of Islamic financing techniques'*, research paper no. 20, Islamic Research and Training Institute, Islamic Development Bank, Jeddah.

Babar K., Majid K., Bibi S., Israr A., & Muhammad I. (2014*). Comparison of Islamic and Conventional Banking Practices Regarding House Finance in Pakistan: A Case of Hazara Division.*Academic Research International Vol. 5(5).

Berger, A., & Udell, G. (1998). *The Economics of Small Business Finance: The Roles of Private Equity and Debt Markets in the Financial Growth Cycle.*Journal of Banking and Finance, 22, 613-673.

Blumberg, B., Cooper, D., & Schindler, P. (2014). *Business research methods*. McGraw-hill education.

Burns, R.,& Burns, R. (2008). *Business Research Methods and Statistics using SPSS.* London. Sage Publications Limited.

Chris, O.,& Diane, M.(2004). *Cross-Sectional Study Design and Data Analysis.*

Copestake, J., Bhalotra, S., &Johnson, S. (2001). *Assessing the impact of Microcredit: a Zambian case study*.Journal of Development Studies, 37 (4): 81-100.

Dehejia, R., Montgomery, H., and Morduch. J.(2012).*Do Interest Rates Matter? Credit Demand in the Dhaka Slums*. Journal of Development Economics, Volume 97, Issue 2, March 2012, Pages 437–449.

Dondo, A. (1999). *The status of micro finance in Kenya*. Paper presented at the annual conference on"New development finance".27 September to 1 October 1999 Goethe University of Frankfurt.

Dusuki, W.(2008).*Banking for the Poor: The Role of Islamic Banking in Microfinance Initiatives.* Journal of Humanomics

Evans, O., Munir, M., Douglas, M., & Stephen, W. (2015). *Loan Interest Rate And Performance Of Small And Medium Enterprises In Kenya*. International Journal of Management Research & Review, Volume 5 Issue 10 Article No-1/712-728.

EY. (2014). *Challenges in microfinance: an EY perspective*, EYG no. EK0314 ED 0115

FDS Kenya. (2015*). FinAccess Business – Supply Bank Financing of SMEs in Kenya*

Gallardo, J., Outra, B., Randhawa, & Steel, F. (2003): *"Comparative review of microfinance regulatory framework issues in Benin, Ghana, and Tanzania",* Policy research working paper No. 3585, World Bank.

Galor,O. & Zeira, J. (2012*).Inequality, Human Capital Formation, The Review of Economic Studies, 60(1), 35-52.*

Gbandi, E., & Amissah, G. (2014).*Financing Options for Small and Medium Enterprises (Smes) In Nigeria.* European Scientific Journal., edition vol.10, No 1 ISSN: 1857 – 7881 (Print) e - ISSN 1857- 7431

George, K. (2015).*Challenges Affecting Transformation of Microfinance Institutions into Deposit Taking Financial Institutions in Kenya.*

Gorder, F. (2009). *Understanding and Dealing with High Interest Rates for Development Studies*. Journal of Development Economics, 15, 1-25.

Government of Kenya. (2007).*Assistance to micro and small and medium enterprises Programme:* A Ministry of Trade Initiative. Nairobi: Government Printer.

Greg, C., Stephen, R., & Xavier R, (2010). *Growth and Vulnerabilities in Microfinance.* Focus Note, No. 61 February 2010.

Hafiz , Z., Roheel, K., Bilal, M., & Muhammad, K. (2014). *Efficiency Analysis of Conventional vs. Islamic Microfinance: An Appraisal for Sustainability in Pakistan.* International Journal of Empirical Finance, Vol. 3, No. 4, 2014, 192-201

Helms, B., & Reille, X.,(2004).*Interest Rate Ceilings and Microfinance: The Story so Far*. Occasional Paper. Washington, D.C.: CGAP.

Hölscher, J., Howard-Jones, P., & Webster, A. (2015*). The Impact Of Loan Financing On The Performance Of Sme's From Non-Eu Transitional Countries.* Business School Bournemouth University, Excecutive Business Centre Holdenhurst Road Bournemouth BH8 8EB., United Kingdom.

Idowu, F. (2010). *Impact of Microfinance on Small and Medium-Sized Enterprises in Nigeria.* School of Management, Wuhan University of Technology, Wuhan, P. R. China.

Institute of Islamic banking and insurance. (2016). *Shari'ah Rulings and Finance*. Retrieved from: http://www.islamic-banking.com/

Ines, B.,& Asma,B. (2013*). Islamic vs. Conventional Microfinance Institutions: Performance analysis in MENA countries*. International Journal of Business and Social Research (IJBSR), Volume -3, No.-5, May, 2013.

Jeniffer, K. (2014). *Effect Of Access To Micro Financing On Financial Performance Of Small And Medium Sized Enterprises In Gikomba Market, Nairobi County.*

Jessica,C. (2016).*Islamic finance for SMEs.* CPI Financial.

Jill, J., Marwan, I., & Vasileios, P. (2012). *A comparison of performance of Islamic and conventional banks 2004 to 200.* Department of Economics, Lancaster University Management School, United Kingdom.

John, A., & Sylvester, V. (2011). *The Challenges faced by Small & Medium Enterprises (SMEs) in Obtaining Credit in Ghana.* Blekinge Tekniska Hogskola, School of Management.

Jonathan, L. (2016) *Practical Lending and Security Precedents Islamic Finance.* Partner, K&L Gates LLP.

Joni, T., Borhan, D., Hedenan, B.,& Towpek.(2006), *Untung Dalam Sistem Perbankan Islam (Theory of Profit in Islamic Banking System) Kuala Lumpur: Department of Publication University of Malaya.*

Karen,E., Alberto,L.,& Juan,P.(2010). *Investigating the impact of access to financial sevices on household investment.* Overseas Development Institute, London.

Karlan, D, & Zinman, J. (2008). *Credit elasticities in less-developed economies: Implications for microfinance*. American Economic Review 98(3): 1040–1068.

Kauffmann, C. (2005). *Financing SMEs in Africa.* Policy Insights, 2005 (7)

Kinyumu, J. (2013). *Operational Challenges In The Growth Of Small & Medium Enterprises In Kisumu County, Kenya.* University of Nairobi.

Kothari, R. (2004) *Research Methodology, Methods and Techniques,* WishwaPrakshan, New Delhi.

Kumar, R. (2014). *Research Methodology: A Step-by-Step Guide for Beginners*. SAGE.

Michael, B., Makarius, M., &Samuel, M. (2009). *Management Of Business Challenges Among Small And Micro Enterprises In Nairobi-Kenya*.. kca journal of business management: vol. 2, issue 1 (2009).

Mislevy, R. (2007). Validity by design. *Educational Researcher*, *36*(8), 463-469.

Mohamed, R.(2013). *Factors Influencing the Growth of Islamic Banks In Kenya.* United States International University.

Mohamed, S., Meryem, D.,& Jhon, F. (2016). *SME's lending and Islamic finance. Is it a "win–win" situation?,* Economic Modelling, Vol 55, Elsevier, B.V.

Nasra, A. (2013*).Islamic microfinance products and the welfare of Muslim community in Kisumu municipality, Kenya.*

Nur, I. (2013). *Islamic Microfinance as An Alternative For Poverty Alleviation: A Survey. Afro Eurasian Studies*, Vol. 2, Issues 1&2, Spring & Fall 2013, 254-271.

OECD, (2015). *New Approaches To SMEs And Entrepreneurship Financing: Broadening The Range Of Instruments.*

Rabobank. (2005). Access *to financial services in developing countries* Rabobank Nederland Economic Research Department.

Raheem, S., & Akhuemonkhan, I. (2014),*Enterprise Development through Incubation Management*, vol.4, no.18.

Rahman, M., Davanzo, J.,& Sutradhar, C. (2006). *Impact of the Grameen bank on childhood mortality in Bangladesh. Glimpse.*P18 (1): 8.

Roodman, D. (2011). *"Due Diligence: An Impertinent Inquiry into Microfinance"*, 19 December 2011, Centre for Global Development.

Rosenberg, R., Gonzalez, A., & Narain, S. (2009). Forthcoming. *"The New*

*Moneylenders: Are the Poor Being Exploited by High Microcredit Interest Rates?".*Washington, D.C.

Roy, G. (2016). *The steady growth of Islamic banking in Kenya.* Daily Nation

Salesius, M. (2015), *Newsline.The professional journal of KASNEB,* Issue no.4 p.14-15

Sa'id, A. (2014)*prohibited elements in Islamic commercial law.* The global university of Islamic finance.

Saunders, M., Lewis, P., & Thornhill, A. (2009). *Research Methods for Business Students*. Pearson Education.

Schreiner, M. & Colombet, H.H. (2001) *From Urban to Rural: Lessons for Microfinance from Argentina*. Development Policy Review, Vol. 19,No.3, 339-354.

Simon, W. (2014). *The effect of microfinance credit on the financial performance of small and medium enterprises in Kiambu county, Kenya.*

Solete, F. (2016). *Evaluation of Factors Determining Demand for Consumer Durable Loans Among Commercial Bank Employees In Kapsabet, Kenya.* University of Eastern Africa, Baraton

Suleman, M., & Nasser (2001), "*Corporate Governance in Islamic Banks."* Society and Economy in Central and Eastern Europe, Quarterly Journal of Budapest University of Economic Sciences and Public Administration, Volume XXII, No. 3.

Trisha, K. (2011). *Examining The Impact of Loans On SMEs In Ghana. (A Case Study of SME Customers In Stanbic Bank).* Kwame Nkrumah University of Science and Technology, Institute of Distance learning .KNUST

Yvonne,S., Geoff, B.,& Loonat, A. (2011)*Consumer awareness and usage of Islamic banking products in South Africa south African journal of economic and management science.* S. Afr. j. econ. manag. sci. vol.14 n.3 Pretoria.

Zaharuddin & Rahman (2007). *Differences between Islamic Banks & Conventional.*

Zikmund, W., Babin, B., Carr, J., & Griffin, M. (2012). *Business research methods*. Cengage Learning.

APPENDICES:

A: QUESTIONNAIRE

This questionnaire is intended to collect data for a study on: *A comparative analysis of the effects of conventional and Islamic banking products on the performance of small and medium enterprises in Kisumu, Kenya.* As one of the business owners/managers in this category, you have been selected as a participant who is best placed to provide the necessary data required. The data you provide will be kept confidential and will be for this academic endeavor only. The data analysis and findings will be reported in terms of the overall situation for several Small and Medium Enterprises in the study. No single response can be traced to the participant. There are two separate parts in section C for those who make use of conventional banking products and others who use Islamic (*Sharia* compliant products) finance. Fill the section relevant to your case; fill both if you use both types of products.

I am therefore kindly asking you to answer these questions candidly and accurately for the success of this important research.

Thank you

Assienin Dova Naka Michael Jordan

SECTION A: BACKGROUND

1. Nature of the business/Category____________________________________

2. Tick the form of ownership

a) Sole proprietorship ☐ b) Partnership c) ☐ limited liability Company ☐

Other (specify) _______________________

3. Location of the business CBD ☐ Off CBD ☐

4. When established____

5. Gender of entrepreneur

Male ☐ Female ☐

6. What is the education level of the Manager? Please tick in the space provided below.

Primary ☐ secondary ☐ Diploma ☐ Undergraduate ☐ Postgraduate ☐

7. What is the main business activity?

____

8. What is the age of your business? Please tic in the space provided below.

1 to 5 ☐

5 to 10 ☐

10 to 15 ☐

Above 15 ☐

9) What is the total number of employees in your business?
…………………………………………………………………

10) Indicate the amount of annual sales; annual profits and annual amount of loan borrowed. Please use the table below by ticking into the appropriate cell.

Amounts	Annual sales	Annual profits	Annual amount of loan borrowed
0 – 50, 0000			
50,000 - 100,000			
100,000 – 200,000			
200,000 – 300,000			
300,000- 400,000			
400,000- 500,000			
500,000- 600,000			
600,000- 750,000			
750,000- 1,000,000			
Above 1,000,000			

SECTION B: INFORMATION ONBANKS PODUCTS (ISLAMIC AND CONVENTIONAL) AND THEIR UTILIZATON

1. Which of these products do you utilize? Please tick the appropriate space provided below.

Overdrafts	☐		
Term loans	☐	Wadiah	☐
Working capital loan	☐	Murabaha	☐
Financial leasing	☐	Musharaka	☐
Loan purchase order	☐	Ijara	☐
Savings accounts	☐	Mudaraba	☐
Import clearing facility	☐	Qardhul hasan	☐
Loan purchase order	☐	Islamic savings account	☐

2. How frequently have you utilized these products (as mentioned above)? Please use the following scale. **0-Never; 1-Rarely; 2-Occasionally; 3-Moderately; 4-A great deal.** Tick in the appropriate space provided in the table below.

	0	1	2	3	4
Overdrafts					
Term loans					
Working capital loan					
Financial leasing					
Loan purchase order					
Savings accounts					
Import clearing facility					
Loan purchase order					

	0	1	2	3	4
Wadiah					
Murabaha					
musharakahh					
mudarabah					
Ijara					
Qardhul hasan					
Islamic savings					

3. Listed below are some suggested reasons why you chose to utilize the product. Against each reason, give the level of importance you attach to each product on the scale given below: **1-Low importance; 2-Slightly important; 3-Neutral; 4-Moderately; 5: Very important.** Tick in the appropriate space provided in the table below.

	Low importance	Slightly important	Neutral	Moderately	Very important
Flexible interest rate					
No restriction on profit making					
Terms and conditions					
Approval levels					
Improve cash flow					
Adequacy					
collateral policy					
absence of Interest rate					
Bank-customer relationship					
Profit or risk sharing principles					
principles on profit making					
Procedural convenience					
Specify if any other					

4. How did you use loans for the last two years? Please tick in the appropriate space provided below.

a) Purchased assets ( )
b) Saved ( )
c) Business expansion ( )
d) Used as working capital ( )
e) Started another business ( )
f) Debt settlement ( )
g) Sourcing of raw material ( )
g) Specify if any other……………………………………

5. Rank the importance of the use of the product to your business, with regard to the following using the following scale: **1-Low importance; 2- Slightly important; 3-Neutral; 4- Moderately; 5-Very important**. Please tick in the appropriate space provided in the table below.

	1	2	3	4	5
Purchased assets					
Saved					
Business expansion					
Used as working capital					
Started another business					
Debt settlement					
Sourcing of raw material					
Specify if any other					
....					

5. . What are some constrains in taking a loan? Please tick in the appropriate space provided in the table below.

High cost of capital	
High risk of default	
Risk of losing collateral used as security	
Prioritizing inflows to settle debt	
Cumbersome procedures	
Inadequate terms and conditions	
State if any other........................	

6. Rank the above constraints in terms of their severity in taking a loan using this scale: **1-Not serious problem; 2-Less serious; 3-Moderate problem; 4-Serious problem; 5-Very serious problem**. Please tick in the appropriate space provided in the table below.

	1	2	3	4	5
High cost of capital					
High risk of default					
Risk of losing collateral used as security					
Prioritizing inflows to settle debt					
Cumbersome procedures					
Inadequate terms and conditions					
State if any other.......................					

SECTION C: THE EFFECTS OF BANK PRODUCTS ON SMEs PERFORMANCE.

Part A: (Islamic use only)

1. Listed below are different levels of the effects of the different banking products on performance of your business. Please Indicate how their effect on the following measures of performance of your business**: 0-Did not use the product; 1-No effect; 2-Minor effect; 3-Neutral effect; 4-Moderate; 5-Major effect.** Please tick in the appropriate space provided in the tables below.

Murabaha	0	1	2	3	4	5
Increase in sales						
Increase in stock level						
Increase in retained earnings						
Increased in profitability						

Mudarabah	1	2	3	4	5
Increase in sales					
Increase in stock level					
Increase in retained earnings					
Increased in profitability					

Ijarah	0	1	2	3	4	5
Increase in sales						
Increase in stock level						
Increase in retained earnings						
Increased in profitability						

Quarh-Ul Hassan	0	1	2	3	4	5
Increase in sales						
Increase in stock level						
Increase in retained earnings						
Increased in profitability						

Savings	0	1	2	3	4	5
Increase in sales						
Increase in stock level						
Increase in retained earnings						
Increased in profitability						

Wadiah	0	1	2	3	4	5
Increase in sales						
Increase in stock level						
Increase in retained earnings						
Increased in profitability						

Musharaka	1	2	3	4	5
Increase in sales					
Increase in stock level					
Increase in retained earnings					
Increased in profitability					

Part B: (Conventional use only)

1. Listed below are different levels of the effects of the different banking products on performance of your business. Please indicate how their effect on the following measures of performance of your business: **0- Did not use the product; 1- No effect; 2-Minor effect; 3-Neutral effect; 4-Moderate; 5-Major effect.** Please tick in the appropriate space provided in the tables below.

Overdrafts	0	1	2	3	4	5
Increase in sales						
Increase in stock level						
Increase in retained earnings						
Increased in profitability						

Working capital loan	0	1	2	3	4	5
Increase in sales						
Increase in stock level						
Increase in retained earnings						
Increased in profitability						

Term loans	0	1	2	3	4	5
Increase in sales						
Increase in stock level						
Increase in retained earnings						
Increased in profitability						

Safe custody	0	1	2	3	4	5
Increase in sales						
Increase in stock level						
Increase in retained earnings						
Increased in profitability						

Import clearing facility	0	1	2	3	4	5
Increase in sales						
Increase in stock level						
Increase in retained earnings						
Increased in profitability						

Financial leasing	0	1	2	3	4	5
Increase in sales						
Increase in stock level						
Increase in retained earnings						
Increased in profitability						

Savings accounts	0	1	2	3	4	5
Increase in sales						
Increase in stock level						
Increase in retained earnings						
Increased in profitability						

Loan purchase order	0	1	2	3	4	5
Increase in sales						
Increase in stock level						
Increase in retained earnings						
Increased in profitability						

SECTIOND:ENTREPRENEUR’S PERSONAL OBJECTIVES

1. What are or where your personal objectives putting up the business? Tick the appropriate answer in the space provided in the table below.

Self-employment	
Major change in personal circumstances	
A desire to pursue an interest or career (divorce, illness, bereavement, education need)	
Better use of skills and abilities	
Need a more flexible and convenient work schedule	
Need for greater independence	
To make sustainable profit	
Welfare of family	
Need to contribute to humanitarian cause	
If any other please specify	

2. To what extent has the utilization of banking products from your bank helped achieve your personal objectives? Please tick the appropriate space provided below: **1-Not any extent; 2-less extent; 3-Moderate extent; 4-Large extent; 5-very large extent.**

Self-employment	1	2	3	4	5
Major change in personal circumstances					
A desire to pursue an interest or career (divorce, illness, bereavement, education need)					
Better use of skills and abilities					
Need a more flexible and convenient work schedule					
Need for greater Independence					
To make sustainable profit					
Welfare of family					
Need to contribute to humanitarian cause					
If any other please specify..					

B: RELIABILITY ANALYSIS

For conventional products

Overdraft

Reliability Statistics

Cronbach's Alpha	N of Items
,981	4

Working capital

Reliability Statistics

Cronbach's Alpha	N of Items
,922	4

Term loan

Reliability Statistics

Cronbach's Alpha	N of Items
,931	4

Import clearing facility

Reliability Statistics

Cronbach's Alpha	N of Items
,961	4

Financial leasing

Reliability Statistics

Cronbach's Alpha	N of Items
,958	4

Savings

Reliability Statistics

Cronbach's Alpha	N of Items
,847	4

Loan purchase order

Reliability Statistics

Cronbach's Alpha	N of Items
,956	4

For Islamic products

Murabaha

Reliability Statistics

Cronbach's Alpha	N of Items
,961	4

Mudarabah

Reliability Statistics

Cronbach's Alpha	N of Items
,909	4

Ijarah

Reliability Statistics

Cronbach's Alpha	N of Items
,939	4

Quard-hul-hassan

Reliability Statistics

Cronbach's Alpha	N of Items
,918	4

Savings

Reliability Statistics

Cronbach's Alpha	N of Items
,852	4

Tawarruq

Reliability Statistics

Cronbach's Alpha	N of Items
,925	4

Salam

Reliability Statistics

Cronbach's Alpha	N of Items
,913	4

Musharaka

Reliability Statistics

Cronbach's Alpha	N of Items
,978	4

Istina

Reliability Statistics

Cronbach's Alpha	N of Items
,932	4

C: LETTERS OF AUTHORIZATION

OFFICE OF THE DIRECTOR OF GRADUATE STUDIES AND RESEARCH

UNIVERSITY OF EASTERN AFRICA, BARATON
P. O. Box 2500, Eldoret, Kenya

02 May 2017

TO WHOM IT MAY CONCERN:

Re: PILOT STUDY OF RESEARCH INSTRUMENT

Assienin D. N. Michael Jordan is a graduate student pursuing the degree **Master of Business Administration (Finance)** at the University of Eastern Africa, Baraton. He is currently writing his thesis entitled ***A comparative analysis of the effect of conventional and Islamic bank finance products on the performance of small and medium enterprises in Kisumu, Kenya.***

To establish the reliability of his research instrument, Jordan is conducting a pilot study. Kindly participate in the pilot study by filling his questionnaire.

Any assistance you will grant him will be greatly appreciated. May God richly bless you in all your undertakings.

Sincerely yours,

Prof. Elizabeth M. Role, PhD
Director

UNIVERSITY OF EASTERN AFRICA
DIRECTOR
02 MAY 2017
Graduate Studies
BARATON

Cc: Chair, Department of Management
Office File

OFFICE OF THE DIRECTOR OF GRADUATE STUDIES AND RESEARCH

UNIVERSITY OF EASTERN AFRICA, BARATON
P. O. Box 2500, Eldoret, Kenya

16 May 2017

TO WHOM IT MAY CONCERN:

Re: REQUEST TO PARTICIPATE IN RESEARCH

Assienin D. N. Michael Jordan is a graduate student pursuing the degree **Master of Business Administration (Finance)** at the University of Eastern Africa, Baraton. He is currently writing his thesis entitled: ***A Comparative Analysis of the Effects of Conventional and Islamic Finance Products on the Performance of Small and Medium Enterprises in Kisumu, Kenya.***
Kindly participate in Jordan's study by filling his questionnaire. He will gather his research data within this month of May 2017.

Any assistance you will grant him will be greatly appreciated. May God richly bless you in all your undertakings.

Sincerely yours,

Prof. Elizabeth M. Role, PhD
Director

DIRECTOR
16 MAY 2017

Cc: Chair, Department of Management
Office File

A SEVENTH DAY ADVENTIST INSTITUTION OF HIGHER LEARNING
CHARTERED 1991

OFFICE OF THE DIRECTOR OF GRADUATE STUDIES AND RESEARCH

UNIVERSITY OF EASTERN AFRICA, BARATON

P. O. Box 2500-30100, Eldoret, Kenya, East Africa

May 15, 2017

Assienin D.N.M.Jordan
University of Eastern Africa, Baraton
Department of Management

Dear Assienin,

Re: ETHICS CLEARANCE FOR RESEARCH PROPOSAL (REC: UEAB/13/5/2017)

Your research proposal entitled ***"A comparative Analysis of the Effects of Conventional and Islamic Finance Products on the Performances of small and Medium Enterprises in Kisumu, Kenya"*** was discussed by the Research Ethics Committee (REC) of the University and your request for ethics clearance was granted approval.

This approval is for one year effective May 15, 2017 until May 15, 2018. For any extension beyond this time period, you will need to apply to this committee one month prior to expiry date. Note that you will need a clearance from the study site before you start gathering your data.

We wish you success in your research.

Sincerely yours,

Dr. Jackie K. Obey
Chairperson, Research Ethics Committee

A SEVENTH-DAY ADVENTIST INSTITUTION OF H IGHER LEARNING
CHARTERED 1991

D: CURRICULUM VITAE

Assienin Dova Naka Michael Jordan

Curriculum Vitae
P.O.BOX 2500-30100, Phone: +25471701327
7
Eldoret.E- mail: dovanaka@gmail.com

EDUCATIONAL QUALIFICATION

2015 : Master in Business Administration – Finance **(In progress)**

2017 : Association of chartered and certified accountants **(In progress)**

20011 to 2014 : Valley View University (GHANA)
Bachelor of Business Administration Banking and Finance

2008 to 2010 : Groupe Scholaire Thanon Namanko (Ivory Coast)
SSS Certificate

EXPERIENCE HISTORY

June to July 2012 : computer Lab assistant (Valley View University)

June to July 2013 : IFS capital management (GHANA)

Position held : marketing agent and assistant accountant

COURSES ATTENDED

Informative Tertiary Train Seminar On Investment & entrepreneurship at valley View University

3 days Entrepreneurship Development Program

COMPUTER SKILLS

- Conversant with Microsoft Word 2003, Microsoft PowerPoint, and Microsoft Excel
- Basic knowledge on how to use Statistical Package for Social Sciences

RESEARCH EXPERIENCE

First Degree : The Emergence of E-Banking and its Influence on the Ghanaian Rural Banking Sector

Second degree : A Comparative Study of Conventional and Islamic Financed Small and Medium Enterprises in Kisumu, Kenya

INTERESTS

Singing, playing piano, listening to motivational messages and reading

COMPETENCE AND SPECIAL ABILITIES

I. Ability to work in a challenging environment
II. Work efficiently to meet deadlines
III. Easily adapt to changes and accept new ideas
IV. Ability to work independently

REFEREES

1. Mrs. Hannah Fosua Gbenda (Lecturer)
   Valley View University
   Oyibi- Accra
   Tel: +233264976566

2. Prof C.T Banaga

   Chair, Management Department
   University of eastern Africa Baraton
   P.O.BOX 2500-30100,
   Tel: +254 718 316 890,