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Effects of Micro-Financing on Growth of Small and Micro Enterprises in Mombasa County

Veronica W. Ngugi[1], Dr F. Kerongo[2]

[1]Jomo Kenyatta University of Agriculture and Technology (JKUAT), Kenya, Department of Economics and Commerce, School of Human Resource Development
[2]Jomo Kenyatta University of Agriculture and Technology (JKUAT), Kenya, Department of Economics and Commerce, School of Human Resource Development

Abstract: ***Majority of small and micro enterprises in Kenya are mostly out of scope of formal banking services. They depend on MFIs loans to finance their business operations. The fundamental objective of this study was to assess the effects of Micro financing on growth of small and micro enterprises in Mombasa County. Despite access to credit SMEs growth remains a major problem. Access to credit should enable a business to achieve their growth objective. Despite this it is interesting to note that most of the SMEs could not survive third year of incubation period. Descriptive Survey method was employed in this study. The study adopted stratified and systematic random sampling method. The sample size was 157 SMEs. Semi-structured questionnaire was designed to facilitate the acquisition of data. Data was collected from 102 respondents, a response rate of sixty five percent. Sales, income and competitiveness were used as the independent variable while growth of SMEs as dependant variable. Descriptive statistics was used to analyze data. Results indicated that microfinance has positive effects on growth of SMEs. Majority of the owners indicated that microfinance has enabled them to expand businesses, build their business assets. Also ability of the business to complete was enhanced.***

Keywords: Small and micro enterprises, Micro financing, SMEs' growth, Microfinance institutions, Mombasa County

1. Introduction

Microfinance refers to small-scale financial services – primarily credit and savings provided to people who operate small and micro enterprises where goods are produced, recycled, repaired, or sold and who provide services to other individuals and groups at the local levels of developing countries, both rural and urban (Robinson, 2001).

In the research paper of Idowu (2010), a major impediment to rapid development of the small and micro enterprises sector is an absence of both debt and equity financing. Accessing finance has been identified as a key element for small and micro enterprises to thrive in their drive to build productive capacity, to compete, to create jobs and to contribute to poverty alleviation in developing countries Idowu (2010). Without finance, small and micro enterprises cannot acquire or absorb new technologies nor can they expand to compete in global markets or even strike business linkages with larger firms Idowu (2010).

Microfinance encompasses the provision of financial services and the management of small amounts of money through a range of products and a system of intermediary functions that are targeted at low income clients (Asiama, 2007). Microfinance or micro credit has therefore been associated with helping empower the low income earners to account properly and independently for their small businesses.

In the research paper of Idowu (2010), a major impediment to rapid development of the small and micro enterprises sector is an absence of both debt and equity financing. Across developing countries, micro and small enterprises are turning to Microfinance Institutions (MFIs) for an array of financial services. The reason is because access to sustainable financial services enables owners of micro enterprises to finance income, build assets, and reduce their vulnerability to external shocks (Ehigiamusoe, 2005).

Empirical evidence emerging from various studies about the effects of microfinance on growth of SMEs has so far yielded mixed results that are inconclusive especially for developing countries like Kenya. In spite of this emphasis previous studies did not provide sufficient justification for the link between micro financing and MSEs growth in the developing countries like Kenya, therefore the question of whether micro financing improves or worsens MSEs growth is stills worthy of further research such as the one being undertaken in this study. In addition, the effects of microfinancing on the growth of MSEs have not received adequate attention in Mombasa County. This means there was a major gap.

2. Statement of the Problem

SMES's need both financial and non-financial services to enhance their productivity, profitability and growth. Sievers and Vanderberg (2004) hold the view that access to financial and business development services are essential for growth and development of Micro and Small Enterprises. The Microfinance industry has become a major backbone in the sustenance and survival of SMEs in Mombasa County and Kenya at large. Microfinance Institutions (MFIs), as part of their core business, provide credit to SMEs. In addition to these financial services, MFIs also provide non-financial services like business training, financial and business management to help improve the capacity of their clients in managing the loan resources granted to them. The number of MFI institutions that provide microfinance services continues to grow rapidly in Mombasa county. However, their wide presence does not correspond with the growth of SMEs in the county. Microfinance institutions have gone a long way to improve small and micro scale enterprises by granting them loans to finance their businesses. Despite this it is interesting to note that most of the SMEs do not survive their incubation period. Access to credit should enable the SMEs to achieve growth but this is hardly the case in the Mombasa County. Majority of the SMEs seem to collapse in the third year of operation. This study is therefore designed to assess the effects of Micro finance on the growth of SMEs in Mombasa County and to propose a more effective approach that the county government and MFIs can adopt in order to meet the growth-oriented needs of SMEs.

3. Objectives of the Study

- To find out effect of income on growth of SMEs
- To establish effect of sales on growth of SMEs
- To evaluate the effect of competitiveness on growth of SMEs

4. Significance and Scope of the Study

The study contributes to the body of knowledge in the following ways; first the empirical evidence on the effects of microfinance services on the growth of micro and small enterprises for use in short term and long term interventions especially in the fight against poverty. Generally, research results have been used as guides to policy formulation and decision making input over the years. In view of this trend, the findings of this study would be used as an additional guide by economic policy makers as regards to SMEs in Mombasa County. This will help them to come out with substantive possible alternative policy interventions which might help micro and small enterprises to achieve growth objectives. The research will be restricted to Mombasa County where the data will be collected from SMEs operators, analyzed, so as to come up with the recommendations.

5. Review of Theoretical Literature

5.1 Micro Credit Theory

Theoretical idea of micro credit has been derived from economic theory that forms the foundation of the credit business in non-communist society. Adam Smith (1937) conceived this theory in the eighteenth century that Self-seeking individuals are always eager to employ their labour, capital and skills to their best interests, which eventually add up to the benefit of the entire society due to the work of the "invisible hand". Smith's idea, later popularized as the theory of capitalism by Karl Marx, describes the principles of material prosperity of the non-communist society. The psychological component of micro credit theory known as "social consciousness driven capitalism" has been advanced by most ardent promoter of micro finance Muhammad Yunus (1994). This theory argues that a species of profit-making private venture can be conceived that cares about the welfare of its customers. In other words, it is possible to develop capitalist enterprises that maximize private profits subject to welfare considerations of their customers.

5.2 Concept of Microfinance

Microfinance is not a new concept. It dates back in the 19th century when money lenders were informally performing the role of now formal financial institutions. Over the past two decades, various development approaches have been devised by policymakers, international development agencies, non-governmental organizations, and others aimed at poverty reduction in developing countries. One of these strategies, which have become increasingly popular since the early 1990s, involves microfinance schemes, which provide financial services in the form of savings and credit opportunities to the working poor. From the year 2000, Microfinance institutions around the world and especially developing countries have grown dramatically in terms of branches, groups, loan disbursement, number of loans, loans collected, and savings clients.

Microfinance enables the low income earners and excluded section of people in the society who do not have access to formal banking to build assets, diversity livelihood options and increase income, and reduce their vulnerability to economic stress. In the past, it has been experienced that the provision for financial products and services to poor people by MFIs can be practicable and sustainable as MFIs can cover their full costs through adequate interest spreads and by operating efficiently and effectively. Microfinance is not a magic solution that will propel all of its clients out of poverty. But various impact studies have demonstrated that microfinance is really benefiting the low income earners enterprises (Littlefield and Rosenberg, 2004).

Microfinance is defined as a development tool that grants or provides financial services and products such as very small loans, savings, micro-leasing, micro-insurance and money transfer to assist the very or exceptionally poor in expanding or establishing their businesses (Robinson, 1998).

In addition to financial intermediation, some MFIs provide social intermediation services such as the formation of groups, development of self confidence and the training of members in that group on financial literacy and management (Ledgerwood, 1999). There are different providers of microfinance (MF) services and some of them are; Non Governmental Organizations (NGOs), savings and loans cooperatives, credit unions, government banks, commercial banks or non banking financial institutions. The target group of MFIs are self employed low income entrepreneurs who are; traders, seamstresses, street vendors, small farmers, hairdressers, rickshaw drivers, artisans blacksmith etc (Ledgerwood, 1999).

5.3 Evolution of Microfinance

Microfinance as an industry evolved in all the third world countries almost at the same time span. World over, it was getting widely recognized that improving income levels of low income community is essential to improve their well-

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being. During the 1970s and 1980s, the micro enterprise movement led to the emergence of Non- Governmental Organizations (NGOs) that provided small loans for the poor. One of the significant events that helped it gained prominence in the 1970s was through the efforts of Mohammad Yunus, a microfinance pioneer and founder of the Grameen Bank of Bangladesh. This economic professor started out by loaning 28 USD for working capital to a group of petty traders and crafts people, mostly women, in the village close to Chittagong University. With a simple system of small and frequent payments and minimal paperwork, the women paid back their loans in full and on time. In 2006, Prof. Yunus was awarded Nobel Peace prize for his efforts to create economic and social development. Many organizations from NGOs to chartered banks have followed in Grameen´s steps, adapting its techniques to widely different environments.

5.4 Micro and Small Enterprises

The SMEs nomenclature is used to mean Small, and Micro Enterprises. It is sometimes referred to as micro, small and medium enterprises (MSMEs). According to kessy and Urio (2006), MSEs can be defined as a productive activity either to produce or distribute goods and or services, mostly undertaken in the informal sector "In Kenya, the MSME bill 2009 has used 2 criteria to define SMEs in general: Number of people/employees and the company's annual turnover. A micro enterprise has less than ten employees and annual turnover of Kshs five hundred thousand while a small enterprise employs more than ten but less than 50 employees and annual turnover of between Kshs five hundred thousand and five million.

5.5 SMEs Growth

The purpose or goal of any firm is to make profit and growth. A firm is defined as an administrative organization whose legal entity or frame work may expand in time with the collection of both physical resources, tangible or resources that are human nature. The term growth in this context can be defined as an increase in size or other objects that can be quantified or a process of changes or improvements. The firm size is the result of firm growth over a period of time and it should be noted that firm growth is a process while firm size is a state. The growth of a firm can be determined by supply of capital, labor and appropriate management and opportunities for investments that are profitable. The determining factor for a firm's growth is the availability of financial resources to the firm. There is different range of indicators of growth of SMEs. Income of the MSEs, Accumulation of business assets, revenue and employment are indicators of growth for the enterprises while household income, household expenditure on (food, education and health) and asset accumulation is the indicator of livelihood of owners of MSEs.

6. Effects of Micro Financing on Growth of SMEs

Accessing credit is considered to be an important factor in increasing the growth of SMEs. It is thought that credit augment income levels, business expansion, competitiveness increase sales volume and thereby more profits. It is believed that access to credit enables SMEs to overcome their liquidity constraints and undertake investments. The main objective of microcredit according to is to improve the welfare of the low income earners as a result of better access to small loans that are not offered by the formal financial institutions.

Diagne and Zeller (2001) argue that insufficient access to credit by the poor just below or just above the poverty line may have negative consequences for SMEs and overall welfare. Access to credit further increases SME"s risk-bearing abilities; improve risk-coping strategies and enables consumption smoothing overtime.

It is argued that MFIs that are financially sustainable with high outreach have a greater livelihood and also have a positive impact on SMEs growth because they guarantee sustainable access to credit by the SMEs (Rhyne and Otero, 1992).

Buckley (2007) argue that, the indicators of success of microcredit programs namely high repayment rate, outreach and financial sustainability does not take into consideration what impact it has on micro enterprise operations and only focusing on "microfinance evangelism".

Carrying out research in three countries; Kenya, Malawi and Ghana, Buckley (1997) came to the conclusion that there was little evidence to suggest that any significant and sustained impact of microfinance services on clients in terms of SMEs growth, increased income flows or level of employment. The focus in this augment is that improvement to access to microfinance and market for the SMEs was not sufficient unless the change or improvement is accompanied by changes in technology and or technique.

Besides, the empirical evidence emerging from various studies such as Mkazi (2007) about the MFIs lending on MSEs performance has so far yielded mixed results that are inconclusive especially for developing countries like Kenya. Zeller and Sharma (2003) argue that microfinance can aid in the improvement or establishment of small enterprises, potentially making the difference between alleviating poverty and economically secure life. On the other hand, Burger (2008) indicates that microfinance tends to stabilize rather than increase income and tends to preserve rather than to create jobs.

Philippines find that expanding access to credit is not associated with an increase in business investment, but with an increase in profit, particularly for men and for men with higher incomes (Karlan and Zinman, 2010). A study of thirteen MFIs in seven countries carried out by Mosley and Hulme (1998) concludes that household income tends to increase at a decreasing rate as the income and asset position of the debtors is improve. Diagne and Zeller (2001) in their study in Malawi suggest that microfinance do not have any significant effect in household income meaning no effect on SMEs growth. Investing in SMEs activities will have no effect in raising household income because the infrastructure and market is not developed. Some studies have also argued that using gender empowerment as an impact indicator; micro credit has a negative impact (Goetz and Gupta, 1994; Montgomery et al, 1996).

7. Research Methods

Descriptive survey research design was adopted in this study to assess the effect of micro financing on the growth of SMEs in Mombasa County. According to Kothari (1990) a research design is the conceptual structure within which research is conducted; it constitutes the blue print for the collection, measurement and analysis of data. The researcher used questionnaires to collect data from SMEs operators, which was analyzed using descriptive statistics. The results were presented using tables, pie and bar charts for ease of understanding.

8. Results and Discussions

Effects of income on growth of SMEs as indicated by the majority of smes operators is positive.80% of the responses indicated that microfinance have helped SMEs to expand the businesses while 20% disagrees. In the same light slightly above of the respondent 53% indicated that they were able to diversify and 47% disagreed. Akyeampong (2002) gave credence to this finding that micro credit schemes had helped MSEs to expand their areas of operation 73% of SMEs owners were able to the increase their assets portfolio while 28% indicated no effect lastly on increase of working capital 85% of the SMEs owners affirmed this while 17% indicated no effect.

A study of thirteen MFIs in seven countries carried out by Mosley and Hulme (1998) concludes that income and asset position of the debtors is improved majority of respondent shows positive effects of sales on growth of SMEs. 89% of SMEs operators responded in affirmative that sales increases their levels of profit while 11% indicated contrary. 79% of the SMEs operator said that their cash inflow was enhanced as result of increase in sales. However 21% of the operators indicated that there was positive effect. Sales enhance the level of production. 89% of the respondent affirmed this while 11% disagreed.

According to the research findings competitiveness has positive effect on growth of the SMEs. 65% of the respondent indicated that competitiveness increase SMEs market share, and 35% of the respondent indicated negative effect. 82% of the respondents believe that microfinance loans contribute to their companies' competition at a highly significant level 18% of the respondents believe that the loans granted to them do not enhance the ability of their companies to compete. 75% of the SMes operators believe that competitiveness as result of micro-financing enhances their production efficiency and 25% of respondents are of opinions that it doesn't. 67% of SMEs owners realized economies of scale while disagreed.

9. Conclusions

Positive and significant relationship has been established between Microfinance loans and SMEs growth. County Government policies and programs designed to develop SMEs are ineffective and thereby need to be re-conceptualized. The county and central government should ease the process of accessing the women fund and youth enterprises funds. Apart from provision of tax incentives, and financial supports, the County Government should try to provide sufficient infrastructural facilities such as electricity, good road network and training institutions. In the midst of these, the researcher wishes to emphasize that the finding of this research clearly indicates that Microfinance has had a positive effects on the growth of SMEs.

10. Recommendations

In view of the findings made and conclusions drawn from the study the following recommendations are provided to help enhance an accelerated and sustained growth in the SME sector and also provide recommendations to help in the improvement of the services of MFIs. The MFIs may be quick to measure their success rate by considering factors like high repayment, outreach and financial sustainability, but these may not be success if their activities do not reflect in the growth of SMEs. The growth of SMEs does not only rely on access to credits but also the creation of favorable and formidable business environment. The MFIs have a great responsibility of ensuring the proper use of credit which is an important facility in business acceleration. To achieve this, credits should client-oriented and not product- oriented. Proper and extensive monitoring activities should be provided for clients who are granted loans. Microfinance institutions should reduce interest rates and increase the grace period to three to six months. The MFIs demand for the payment immediately of the loans advanced to borrowers. The longer the grace period will enable borrowers to pay interest and principal using income generated from the borrowed money. This will accommodate more startup MSEs to participate in MFI lending. Finally, the researcher recommends that business and financial training should be provided by MFIs on a regular basis and most cases should be tailored toward the training needs of the clients.

11. Limitation of the Study

11.1 Time Factor

In carrying out this study, the researcher faced time limitations as the study was conducted in normal working hours, as the researcher is a full time employee. To overcome time limitation the research hired research assistant to help in collecting data.

12. Areas of Further Research

- Some of few areas that are related to the topic studies are suggest
- Examining the sustainability of an interest free microcredit scheme by financial non-governmental organizations
- Establishing effects of interest rates of MFI loans on the growth of SMES
- Evaluating the effects of sound bookkeeping practices on growth of SMEs

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Author Profile

Veronica Ngugi received Diploma in Business Administration and Higher National diploma in Business Management from Mombasa Polytechnic in 1999 and 2006 respectively. In June 2012 received Bachelor of Business Administration degree from Jomo Kenyatta University of Agriculture and Technology. From May 2012 to date am a student at the above mentioned university pursuing Master degree in Business Administration finance.