



Full Length Research Article

THE EFFECT OF MFI CREDIT ON ASSETS OF SMES; A SURVEY OF SMALL MEDIUM ENTERPRISES IN NAKURU TOWN

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ABSTRACT

SMEs sector is the source of income for more than 8 million people who represent the majority of working Kenyans. Despite their large contribution in development and economic performance they are mainly inhibited by access of finance. Large commercial institutions have failed to serve the SMEs in both urban and rural communities. They perceive them as lacking the ability to provide the quality services and are unable to satisfy more critical projects. Three out of five SMEs fail within first few months of operations because of negative perception towards SMEs. Given the importance of small businesses to the Kenyan economy and the exposure to risks owing to their size, there was need to conduct an empirical enquiry to investigate the effect of MFI Credit on Assets SMEs in Nakuru Town. The study used both quantitative and qualitative data. Primary data was collected through observation and structured questionnaires. The population was 700 SMEs in Nakuru Municipality. Out of this a sample 248 SMEs was selected on basis of Krejcie method of determining sample size. These were categorised into two the SMEs that receive credit from MFI and those that do not. Frequency tables and graphs were used to display the results and the relationships between the variables on enterprise performance were measured using correlation techniques. The variables used in this study were assets as a dependent and MFI credit as independent variable. The study found out that there is a strong positive correlation between MFI credit and assets.

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INTRODUCTION

In many emerging markets the Small and Medium Enterprises (SMEs) sector is one of the principal driving forces for economic and job creation. SMEs and micro-enterprises constitute over 95 per cent of all enterprises and account for two thirds to one half of total non-farm employment and gross domestic product (GDP) worldwide. SMEs play pivotal roles in creating dynamic, market oriented economic growth, employing the growing workforce in developing countries, alleviating poverty and promoting democratization (UNDP, 1999). However, inadequate access to financing continues to be one of the major significant impediments to creation, survival and growth of SMEs in Africa. Further owing to their high risk profile, SMEs in Africa largely remain an unattractive investment for mainstream investors.

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Of particular concern for investors are the country, currency and credit risks characteristics of many African countries in which SMEs operate (UNEP, 2007). While the definition of SMEs varies from one country or continent to another, most of these theoretically the most appropriate. However an availability of capital and output figures frequently requires that SMEs be defined based on employment alone. Dondo in 1990 in his study of the "Changing role of key institutions actors in implementing credit programs for small scale enterprises development in Kenya" with K-rep; defined small enterprises as an enterprise with fewer than 50 employees. Parker and Torress in 1994 in their study of "Micro and Small Scale Enterprises in Kenya, defined "micro- enterprise" are those with 10 or fewer workers; "small enterprises" have from 11 to 50 workers and "medium enterprises" have from 51 to 100 workers. There are more than 800,000 small, medium and micro enterprises in the country (GOK, 2004). In 2003, Kenya's SMEs contributed about 18 percent of GDP and employed 5.1 million representing 74 percent of Kenyan labour force (Obwocha, 2006).

The 1999 National Baseline survey conducted by central bureau of statistics, ICEG and K-Rep holdings provides the most recent comprehensive picture of SMEs in Kenya. (Mead, 1998) observes that health of economy of as a whole has strong relationship with the health and nature of SME sector. When state of the micro economy is less favourable, by contrast, the opportunities for profitable employment expansion in SMEs are limited. This is true for those SMEs that have linkages to larger enterprise and the economy at large. Given this scenario, an understanding of dynamics of SMEs is necessary not only for the development of support programmes for SMEs, but also for the performance of the economy as whole.

The SMEs have very limited access to financial services from formal financial institutions to meet their working and investment needs (Kessy, 2010). However, the generation of self-employment in the SMEs requires investment in working capital, at low levels of income, the accumulation of such capital may be difficult. Under such circumstances, loans can help the poor to accumulate capital and investment in employment generating activities (Hossain, 1988). According to (Grade, 1984), loans enable the individual's member or enterprises to enjoy the benefit of economies of scale and new technology. Availability of credit to small business and low income SMEs could greatly enhance their economic strength and eventually break the vicious circle of low income – low saving – low investment – low income (Yunus, 1984).

LITERATURE REVIEW

A key impact of microfinance is to help clients accumulate or retain physical assets (Sebsad, 2000). Assets are increased either through direct loan use, as a benefit of income smoothing, or through the use of profits generated through the investment of a loan. Clients can also protect existing assets through the investment or by using savings or credit to cope with shocks when they occur. Poor households invest in physical assets for three main reasons: household assets which primarily contribute to quality of life, and may also provide security and possible income in the case of future need; productive assets which are used to generate income, such as land/houses for rent or equipment for a business.

(Xu, 2000), noticed that financial institutions facilitate growth by focusing on capital formation and extending the capital in form of credit to different economic units. From this perspective, capital formation and distribution can be influenced by financial institutions through altering the savings rate or by reallocating savings among different capital producing technologies. Liquidity is crucial in this perspective of economic growth. The high-return projects involve a long-run commitment of capital and savers are generally reluctant to lose control of their savings for a long time. The task of financial institutions is to enhance the liquidity of long-term investments so that more investment is expected in the high-return projects. According to Hicks the industrial revolution in England was mainly caused by the financial institutions' improvements that moderated liquidity risk (Levine, 1997).

As development takes place, one question that arises is the extent to which credit can be offered to the rural poor to facilitate their taking advantage of the developing entrepreneurial activities.

The generation of self-employment requires investment in working capital. However, at low levels of income, the accumulation of such capital may be difficult. Under such circumstances, loans, by increasing family income, can help the poor to accumulate their own capital and invest in employment-generating activities (Hossain, 1988). (Gibrat, 1931), suggested that there is no relationship between the size of a firm and its growth. This is known as Gibrat's Law or the Law of Proportionate Effect. In fact, firm growth is the result of a multiplicative process that affects the initial size. The factors that can affect firm growth relate not only to the firm, but also to its environment. The main consequences of Gibrat's Law are as follows (Sutton, 1997): There is no optimum size to which firms will converge, the likelihood of growth is independent of initial size, so expected growth and its variability are the same for all firms, past growth does not affect current growth since there is no serial correlation (both between firms and over time), firm size dispersion increases over time, so market concentration is higher if the number of firms remains constant and the variance of firm growth rates is equal for all sizes. This means that the variance of firm growth rates for small firms is equal to the variance of firm growth rates for large firms. In other words, Gibrat's Law postulates that the "probability that the next opportunity is taken up by any particular active firm is proportional to the current size of the firm" (Sutton, 1997).

According to (Guralnik, 2004), financial performance is achievement which is often used to show the ability. On the other hand, (Bernardin & Russell, 2009) define that financial performance is the record of the result which is gained from the function of certain work or certain activities in the certain period of time. In SME perspective performance means how business has grown in terms of revenue. Though physical assets in business depreciate a business that is performing well will have a growth in assets in term of cost. This is through acquisitions of new assets. In the perspective of business management, environment is the important and contextual factor which has the effect to the performance of the company (Child, 2000). The concept of modern management shows that the industry which is conducting an economic activity does not stand independently, but it is in the business environment which is affected each other. Generally, the company is in the centre of business environment that consists of government, people, customers, distributors, employees and the same industry which also being the competitor.

METHODOLOGY

The research employed both quantitative and qualitative methods of research. Quantitative method was used where it was possible to estimate and measure to value of assets while the other method was used where it was not possible to quantify, that is areas such as beliefs, values and opinion. Correlational descriptive technique was used because the researcher did not control or alter the valuables. The intention was to describe how they influence one another. (Burns, 2001), descriptive research is designed to provide a picture of a situation as it naturally happens. It may justify current practice and make judgement and also to develop theories. Purposive or judgemental sampling procedure was used to elicit high responses by targeting people who are reliable for research. According to Kombo and Tromp (2006), purposive sampling is ideal, where the researcher want to target people reliable for research.

A sample of 248 SMEs was used for this research, out of an estimated population of 700 SMEs. Krejcie method of sample selection was used to determine the sample for this study.

RESULTS

Data Analysis and Interpretation

Asset Trend of SMEs that Receive Credit from MFI

Total assets were obtained by adding mean value of fixed assets with mean value of current assets in a period from 2008 to 2012. These values were obtained and then a line graph was drawn to see the trend of SMEs that receive MFI credit and those that do not.

Table 1. Assets Trend of SMEs that Receive MFI credit and those that do not

Assets trend of SMEs that receive credit.	2008	2009	2010	2011	2012
Fixed Assets sh(million)	2.5	3.1	2.9	2.8	2.7
Current Assets sh(million)	1.2	1.0	1.9	2.1	2.3
Total Assets sh(million)	3.7	4.1	4.8	4.9	5.0
Assets trend of SMEs that do not receive MFI credit.					
Fixed Assets sh(million)	2.6	2.5	3.1	3.1	3.1
Current Assets sh(million)	1.0	2.0	1.8	1.8	1.9
Total Assets sh(million)	3.6	4.5	4.9	4.9	5.0

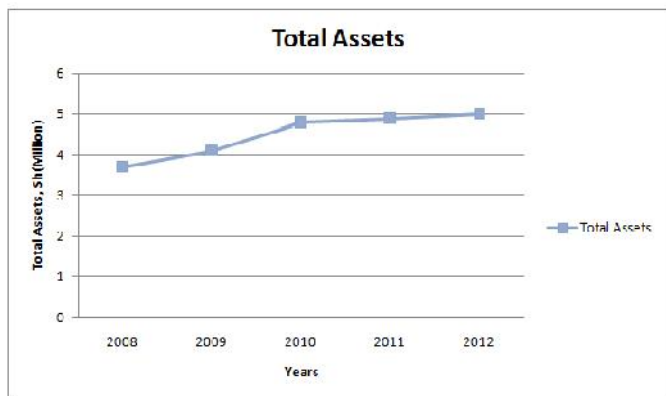


Figure 1. Assets trend of SMEs that Receive MFI credit



Figure 2. Assets Trend of SMEs that do not Receive MFI credit

Figure 2 displays the trend of Assets of SMEs that receive credit from MFI. The growth had been in upward trend, in the year 2008 to 2010. From 2009 it was rising at high rate upto 2010.

There was slow growth in assets between the years 2010 and 2012. Total assets in 2010, 2011 and 2012 were sh4.8 million, sh4.9 and sh5 million respectively. In 2008 the assets were at their lowest level at sh3.7million. There was change in trend in the year 2010 where there was a slow growth of assets.

The assets reached a maximum value of sh5million in the year 2012 and were lowest in 2008 with a value of sh3.6 million. SMEs were able to invest in assets, in the year 2008 to 2010, because their working capital must have gone up, which arose due to increased revenue. Revenue boosts the growth of business. This ideal environment for growth was facilitated by funds from MFIs. Between 2010 and 2012, the SMEs must have been operating under pressure, because though, there was growth, it was not as high as the previous two years. Investment in assets was low, an indicator that SMEs must have been having setback, either through shrinking turnover or inadequate funds from financiers that is the MFIs. The trend of SMEs that receive MFI credit was almost as those that do not receive with only a small difference of assets. In the year 2009, total assets were sh4.5million and in 2010 they were sh4.95million. The curve of SMEs that do not receive MFI credit was rising gradually as opposed to that of SMEs that receive MFI which was rising sharply. This comparison explains that with availability of several MFIs in Nakuru, research area, the rather rapid rise of assets must have been boosted.

DISCUSSION

Three out five Small Medium Enterprises die in first year of operations according to Kenya Bureau of Statistics (2007). The major course and challenge of business collapse being poor perception towards them. Over years large commercial financial institutions, have disregarded them, perceiving them as too small and not worthy for credit. According to (Ogawa and Suzuki 2000) bank do not want to offer loans to SMEs because the nature of loans required is too small and those banks find it more expensive to offer such loans. (Cook & Nixson, 2000), posit that SMEs development is inhibited by access of finance, poor management skills, lack of training opportunities and high cost of loans. Study done by (Rweyemamu et al, 2003) revealed that, formal financial institutions have failed to serve the SMEs in both urban and rural communities. SMEs in comparison to large businesses are endangered in terms of business survival. The concept of going concern does not hold, despite being major source of employment in developing countries. Particularly in Kenya, they employ over 8 million people who represent majority of working Kenyans.

This study found out that there was rather rapid growth in assets for SMEs that receive MFI credit while those that do not receive the growth were just gradual. Micro financiers of small businesses have contributed to the rapid growth. Small businesses need financial support from institution that understands their problem. They don't not only need financial solution, but also they need expertise management skills. Most Micro financiers offer remedy to this problem. They offer business financial advisory services as well as financial services to micro-investors this explains why growth in assets was rather rapid. (Sebsad, 2000) , revealed that the key impact of microfinance is to help clients accumulate or retain physical assets.

Assets are increased either through direct loan use, as a benefit of income smoothing, or through the use of profits generated through the investment of a loan. Micro businesses can also protect existing assets through the investment or by using savings or credit to cope with shocks when they occur. Such businesses, however, cannot grow rapidly as compared to those that get loans from micro finance institutions. This is because it would boost the business more to make investments using borrowed money, instead of trying to accumulate savings with an objective of making business investments. However, it is important to establish a sinking fund to cushion the business from sudden misfortune such as loss of revenue or collapse. The intention of such fund is not for investments but a business cover for unseen future event. Small businesses are unable to establish such a fund because most of their income is used in recurrent expenditure and therefore left with little income to put in such a fund. This makes them to be highly volatile in collapsing.

Conclusion

High frequency of small business collapsing is due to inadequate funds, which make it impossible to accumulate assets. There are also other reasons such as lack of expertise in business management and poor record keeping which contribute to collapse of small businesses. Due to their nature, they need assistance from institutions that can best understand them. One of such institution is microfinance. Most of the microfinances are designed to handle the short term and long term problems of microfinances. They offer advisory as well as financial solutions to SMEs. There are however, many small microfinance businesses that have mushroomed in area of study, Nakuru. Therefore small business investors must carefully analyse and select a genuine micro finance from fake ones. The hidden cost of loans should be of concern to a small investor because such hidden cost will harm small investors business. Genuine micro finance businesses care for their customer's interest, and they are able to accumulate assets through use of affordable loans.

Recommendation

Small business investors should be adequately informed about business funding, record management and business management skills if they want to increase their assets. This is because such information is inadequate to many small investors. They should make use of microfinances which they can trust because they have been made specifically to support such businesses. Thorough investigations about the microfinance should be made, before getting into contract with them, to avoid getting into contract with fraudsters. That is, they should get into contract with microfinance which are recognized under the law, and regulated by government financial regulator. Small businesses that rely on their own savings to make investment should change such style of doing business.

They should borrow money from a financial institution preferably registered microfinance institution to speed up business operations. It is also necessary to keep track of asset growth of small businesses, so that necessary decisions are made of ensuring business short term and long term business stability. Business consultation services are important to ensure growth of businesses but small businesses rarely use such services because of cost involved. Micro finance institutions offer these services to small business owners at no cost, the only charges they incur are loan charges. Therefore small business owners should always adequately consult business advice from micro financiers any time they borrow money from them.

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