INTERNATIONAL JOURNAL OF
SCIENCE ARTS AND COMMERCE

EFFECT OF MICRO-FINANCE ON FINANCIAL PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES IN KWALE COUNTY, KENYA

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ABSTRACT

This study sought to examine the effect of micro-finance on financial performance of small and medium enterprises in Kwale County, Kenya. The study adopted a descriptive research design and had a target population of 813 Small and Micro Enterprises managers in Kwale County, Kenya. The study sample was obtained using Yamane's sampling formula hence 274 SME managers were engaged in this study. Research data was collected using primary and secondary tools. Primary research instruments were tested for validity and reliability before analysis and presentation of findings. Data was analysed using descriptive and inferential statistics using SPSS and presented in tables and graphs. Study findings established a strong positive relationship between micro-credit, micro-training, micro-insurance and micro-savings and financial performance of Small and Medium enterprises in Kwale County, Kenya. It was therefore concluded that; microfinance positively influences the financial performance of small and medium enterprises in Kwale County, Kenya. The study recommended for training of SME managers on the various loans offered by microfinance so that they can choose wisely based on the need and ability to repay to discourage loan defaults.

Key words: Micro-finance, Small and medium enterprises, financial performance.

1.0 INTRODUCTION

Microfinance service is a set of financial service targeting middle income earners and the poor in the society who previously not served by commercial banks. The main products offered by microfinance institutions include; micro-credits, investment funds, micro-training and micro-insurance (Akindele and Odusina, 2015). Microfinance is term used to define a banking service that is provided to unemployed individuals or poor people in low neighborhoods within cities or the rural areas (Munuve, Githui & Omurwa, 2020). These services provided by microfinance has been offered in the country for decades, however, in the recent past it has undergone major transformations to meet the needs of the target groups. With the growth of the sector in capacity, middle income earners have also become part of the target group while some microfinance have become fully fledged banks. The Government of Kenya (GoK) has in a roundabout way given a lift to the microfinance area. Different establishments give assortment of administration to help the SME area (Mpanju, 2019). Micro finance empowers customers to secure, broaden and increase their earnings, just as to aggregate resources, diminishing their vulnerability to pay and utilization stuns (Musti and Mallum, 2020). Micro-finance institutions can be measured in two dimensions (Mnunka and Oyagi, 2020). One is its effort to needy individuals, that is, its capacity to give helpless families access to credit to monetary administrations. The other measurement is its return on investments made to serve the small and medium enterprise. The study used the measure on returns to assess the financial performance of microfinance serving small and medium enterprises in Kwale County. According to Pais and Hama (2015) financial performance of a firm can be described as the measure of a firm's capacity in attaining set goals through good management and utilization of resources it owns. As stated by Kuci (2018) financial performance is a very critical component in the management of an organization, the decisions regarding expenditure are assessed if appropriate to the firm based on the returns that a firm gain. Financial managers across industries attempt to increase or multiply firm returns and limit losses through efficient and effective utilization of organization resources.

The performance of small and medium enterprises was measured using a number of metrics that look in both financial and non-financial aspects of the organization (Wasiuzzaman, 2015). In assessing financial performance, most scholars rely on financial ratios such as liquidity, solvency, profitability, repayment capacity and financial efficiency. Given that the targeted organisations i.e small and medium enterprises had poor record keeping the study measured financial performance of the SME, this study assessed the performance of SMEs by looking at the solvency of the small businesses. This measure made it possible for SME managers tell the amount of money they had borrowed, invested and the progress they have made after starting the business (Nobanee and Abraham, 2015).

1.1 RESEARCH PROBLEM

Today a number of microfinances offer a wide range of non-financial services such as financial training on savings, budgeting and investments. In addition, micro-finance offers insurance services that mitigate losses that arise from business operations (Yeboah, 2017). These new concepts integrated into the financial practices of microfinance business are in line with the assumptions of dynamic theory proponents who advocate for acquisition of new methods and improvement of business process in order to survive in a competitive financial market. With a wide range of products offered by micro-finances today, it's been challenging to most SME owners to find the right combination of microfinance services to enhance SME adaptability and improve on their financial performance has not been clearly spelt out. This created a sense of uncertainty on SME owners on whether to integrate all micro-finances services to their businesses or focus on the most relevant services.

Mbiti, Elegwa, Joseph and Dorothy (2015) researched the impact of credit services on development of SMEs run by women in the county of Kitui. It was established that women in business face difficulties during time spent in getting the funds while borrowing start businesses. The study does do not show a direct relationship between microfinance and the SMES. Mutuma and Omagwa (2019) looked to set up the impact of micro-finance services on performance of SMEs in Meru County in terms of finance. The investigation discovered a genuinely solid positive connection between services of micro-finance and performance of SMEs in terms of finance. Masini (2015) investigated the impacts of microfinance institutions on monetary execution of SMEs in the town of Machakos. The outcome of the investigation revealed that MFIs micro savings, small credits and teaching possessed a genuinely strong positive connection on the monetary performance of the SMEs. Monge (2016) investigated the effect of small credits on execution of SMEs in the municipality of Dar –es- salaam in Tanzania. Most of the studies reviewed targeted only small and medium enterprise managers leaving out officials from micro-finance institutions that could have shed light on critical issues relating to micro-financing. This study therefore sought to fill the gap left by the reviewed studies.

1.2 OBJECTIVE OF THE STUDY

The study examined the effect of micro-finance on financial performance of small and medium enterprises in Kwale County, Kenya.

2.0 THEORETICAL REVIEW

The study's theoretical review comprised of the Pecking Order theory; Resource based theory and Dynamic trade-off theory.

2.1 Pecking Order Theory

As cited by Myers in 1984, organizations like to utilize internal finances first and go for borrowed funds if interior sources are equity is not enough (Okafor, 2020). Different scholars have established that small and medium have varied capital requirements depending on the sector they operate in. also based on management characteristics, the choice of financing between equity and debt considerable varies. Due to their exclusion from primary financial markets like banks, SMEs have most relied on private sources such as family and social support to finance their businesses (Khan, et al. 2020). The most common reasons for not accessing credit from banks is information asymmetry and lack of collateral to act as security. This theory is helpful in explaining capital acquisition decisions in nearly all situations; the expense of getting capital to finance upcoming ventures is normally higher than it is for bigger organizations (Omondi and Jagongo, 2018). Due to information asymmetry, lenders find it difficult to score the credit worthiness of small scale enterprise owners hence classify the as high risk creditors. The consequences of being categorized as a high risk borrower show that they can easily default hence charged higher rates or have their little assets attached to the loan as collateral (Khan, et al. 2020).

When crediting to small ventures, most monetary establishments require the proprietors of the private companies to actually ensure the advance (Michello and Wanorie, 2015). Perhaps the most recognizable inadequacy of the theory is that it neglects to consolidate the impact of expenses, cost of giving new protections, office cost, monetary misery which decide the whole amount that can be reimbursed back to the money lender (Wasiuzzaman, 2015). However, this theory was used in this study as it was relevant in explaining SME credit acquisition decisions, as most SMEs start with internal financing before looking for external sources.

2.2 Resource-Based View Theory

This theory was developed by Penrose in the 1959s, the resource based theory (RBV) is based on the assumptions that to gain optimum benefit from the use of organization resources managers need to be rational in deciding the type of financial product they prefer between debt and equity (Aladejebi, 2019). These set of believes have contributed heavily in the shaping managers understanding of resource utilization and the significant role it plays in enabling firm competitiveness. A single source of income or resource is not sufficient to guarantee the survival of a business, so managers are required to create a pool of resources either through equity or debt so as to be in a position to meet business financial needs and other financial obligations (Nobanee & Abraham, 2015). Without diversity in organizations capabilities and resources, opportunities for strategizing and competition would be reduced. Accordingly, RBV expects that organizations influence their interesting heaps of assets to accomplish competitive advantage (Sussan and Obamuyi, 2018). Proponents of the theory call for managers in both small and medium enterprises and well established companies to at all times to take stock of their financial and none-financial resources so as they can understand their strength and compete effectively with their immediate rivals. With the right people, infrastructure, equipment's and sufficient cash, it may be impossible to take on opportunities that are profitable or diversify businesses into areas that are emerging and very promising in other sectors of the economy, (Akingunola, Olowofela & Yunusa, 2018).

RBV point of view is grounded on in thoughts that organizations are heterogeneous and factors are incompletely portable among firms (Aktas, Croci & Petmezas, 2015). These assumptions become hazardous in the current period where speeding up of innovative change; globalization, trans-hierarchical coordinated effort and the accessibility of profoundly talented work imply that assets are progressively versatile and open to firms around the world (Aktas, Croci & Petmezas, 2015). For instance, open source code, permitting arrangements and different types of inter-organizational collusions have particularly made everything fair in numerous businesses. Considering these conditions, a few analysts recommend that competitive advantage will rise out of powerfully reconfiguring assets after some time as opposed to the assets themselves (Aladejebi, 2019). The study found this theory appropriate for this study in the sense that, it clearly explained the importance of developing employees as a resource through training offered by financial institutions with an aim to improve SME financial perfomance.

2.3 Dynamic Trade-off Theory

This theory is attributed to David Teece who developed it in 1990, who stated that business make effort to find new resource for the organization that give such an organization an edge over its competitors (Badullahewage, 2020). As reported by Hailu and Venkateswarlu (2016) organization redevelop or adopt new organization frameworks to fit in their new work environment. Firms who adopt to change easily survive; however, changes especially in terms of technology and human resources require huge financial investments that can be challenging to small and medium enterprises. In making financing decisions, managers of small and medium enterprises focus on areas that will earn the business above normal profits so that they can meet their operation expenses, save and invest in other portfolios that expand the business empires (Mahat and Zannah, 2017). Due to harsh economic times and scarcity of resources, business managers have to borrow to finance their business operations. Due to the capacity and resources they hold, small and medium business managers rely on informal and formal financing institutions that have a framework of supporting such kind of businesses (Pais and Hama, 2015).

Small and medium businesses do not operate in a vacuum, they face tight competition from big companies that target the same customers with superior and quality products (Iqbal, 2015). In an attempt to compete effectively, most small businesses have failed to make an impact due to mismanagement of finances. Managers have poor track of money borrowed, spent and earned which complicates their credit worthiness hence fail to qualify for loans. The misappropriation of money has been linked to such issues as lack of skills and experience that affect the planning and implementation of strategies that could easily give an edge of the businesses over the others (Farghly, Saleh, Youssef, & Bary, 2018). The theory was useful in this study, as it helped in finding the relevance of training, insurance and savings that were adopted by SMEs to enhance their financial performance.

3.0METHODS

The study adopted a descriptive research design. The study population consisted of 873 SME's managers in Kwale County, Kenya. 274 were sampled out of the total population. Questionnaires were administered to the sampled population. Prior to the main study a pilot study constituting 10% of the targeted respondents was carried out. As such, therefore, 26 respondents took part in the pilot study. The respondents who participating in this study were excluded from the main study (Kothari and Garg, 2014). Data was analysed using correlation and the regression model stated below;

$$Y = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \varepsilon$$

Y = Financial performance

X_1 = Micro-Credit

X_2 = Micro-Training

X_3 = Micro-Savings

X_4 = Micro-Insurance

ε = Error term

β_0 indicates the intercept of the model which is a constant.

β_1 to β_n i.e. β_1, β_2, β_3, β_4 are constants that show the coefficients of each of the independent variables of the regression model

4.0 RESULTS

Correlation analysis was done to establish the strength of the relationship between the independent variables; Customer relationship management, Leadership style driver, Change management style driver and Organization learning on performance of the Revenue Authority, Southern region Mombasa. The significance levels of the relationships are shown below;

Table 1: Correlation Analysis

	FP	MC	MT	MS	MI
FP	1				
Sig. (2-tailed)					
MC	.560**	1			
Sig. (2-tailed)	.012				
MT	.601**	.716**	1		
Sig. (2-tailed)	.003	.074			
MS	.695**	.806**	1.000**	1	
Sig. (2-tailed)	.0019	.0043	.0022		
MI	.651**	.522**	.806**	.606**	1
Sig. (2-tailed)	.0031	.0026	.003	.004	

Source: Research Data (2021)

Where

MC = Micro-credit **MT** = Micro-training

MS = Micro-savings **MI**= Micro-insurance

The results Presented above show a positive relationship between micro-credit, micro-training, micro-savings and micro-insurance and financial performance of SMEs in Kwale County, Kenya.

Regression Analysis

Table 2: Regression Analysis

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig	Collinearity Statistics	
	B	Std. Error	Beta			Tolerance	VIF
(Constant)	4.643	1.399		3.319	.000	-	-
MC	.271	.108	.301	2.509	.037	.880	1.136
MT	.356	.219	.423	1.626	.000	.972	1.029
MS	.599	.092	.651	6.498	.018	.892	1.121
MI	.458	.081	.503	5.654	.030	.789	1.021

Source: Research Data (2021)

Key;

MC: Micro-Credit

MT: Micro-Training

MS: Micro-Savings

MI: Micro- Insurance

From table 2 above, it can be observed that the study had an intercept of 4.643 which implies that when all other factors are held constant at zero, microfinance service variation in financial performance would be 4.643; Micro-Credit has a positive significant influence on performance; Micro-Training has a positive significant influence on performance; Micro-Savings has a positive significant influence on performance and Micro- Insurance has a positive significant influence on performance because their p-value are less than the critical p-value of 0.05.

$$Y= 4.643+ 0.271X_1 + .356X_2+ .599X_3+ 0.458X_4$$

From the above regression results, it can be deduced that a unit change in Micro-Credit influences financial performance by 0.271, a unit change in Micro-Training influences financial performance by .356, a unit change in Micro-Savings influences financial performance by .599 while a unit change in Micro- Insurance leads to 0.458 change in financial performance.

5.0 CONCLUSION

Study findings established: a strong positive relationship between micro-credit and financial performance of SMEs in Kwale County, Kenya; a strong positive relationship between micro-training and financial performance of SMEs in Kwale County, Kenya; a strong positive relationship between micro-insurance and financial performance of SMEs in Kwale County and a strong positive relationship between micro-savings and financial performance of SMEs in Kwale County, Kenya. It therefore concluded that; microfinance positively influence the financial performance of small and medium enterprises in Kwale County, Kenya. Furthermore, it was concluded that; easy access of credit, meeting of financial and provision of short term loans that meet emergency situations; sufficiency of training on management skills and Loan management training; attractive interest rate on savings and convenient savings through MF mobile banking platforms and provision of essential insurance covers and favourably compensation period were the main factor contributing to improved financial performance of SMEs in Kwale County.

5.1 Recommendations

Although the study established a positive relationship between microfinance services and financial performance of SME in Kwale, there is need for improvement in a number of areas to better improve the microfinance services in Kwale County, Kenya. As the study recommends for training of SME managers on the various loans offered by microfinance institutions so that they can choose wisely based on the need and ability to repay to discourage loan defaults. The study also recommends for continuity of training to ensure that SME managers are able to carry their businesses through all business cycles, it was noted that training services are offered only when a customer seeks credit. Furthermore, microfinance managers should also encourage SME to save more with them so that they can be liquid and buy shares in the financial institutions and discourage savings as a basis of acquiring a loan. Lastly, microfinance managers should educate their customers on the importance of insurance into their businesses, during the study many respondents indicated that they take insurance but see it as a liability as they do not claim funds contributed.

5.2 Suggestions for Further studies

The study findings covered only 63.4% as indicated by r-square in the model summary while 36.6% of other factors affecting financial performance of SME in Kwale County, Kenya, were not covered, a study should therefore be carried out to identify the other factors affecting financial performance of SMEs in Kwale County, Kenya. Furthermore, a study should be done on large firms within the county to understand how microfinance within Kwale Count, Kenya, influence their financial performance. Lastly, similar studies as suggested for SME and large firms should be done in other counties across the country so as to compare if similar findings will be established.

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