ISSN 2349-7831

International Journal of Recent Research in Social Sciences and Humanities (IJRRSSH)
Vol. 5, Issue 2, pp: (181-185), Month: April - June 2018, Available at: www.paperpublications.org

EFFECT OF MICROFINANCE CREDIT ON THE GROWTH OF SMALL AND MEDIUM ENTEPRISES IN KIAMBU COUNTY

[1]NEWTON K LANGAT, [2]DR. TOBIAS OLWENY

Abstract: **This study sought to investigate the effect of micro financing on growth of SMEs' in Kiambu County, The demand for micro-finance service in Kiambu county is high yet the industry is only able to meet about 20 percent of their demand because of lack of financial resources and the capacity to assess risk process and monitor loans. Small and medium enterprises (SMEs') face challenges in obtaining funds from large and formal financial institutions therefore opt for loans from micro-financial institutions to fund their business projects. The study was geared towards the recognition of the importance of micro financing on the growth of SMEs'. SMEs' have benefited from microfinance institutions through the provision of equity/capital for start-ups, moreover, micro finance institutions also offer business support to the SMEs' before start up by developing a business proposal of their choice and helping them in developing a savings scheme. Among the limitations of the study were lack of time and access to resources necessary to aid the study such as the necessary funding. The study concluded that adjustable loan significantly and positively influenced business growth among small medium enterprises. The study also concluded that fixed term loans have a significant and a positive effect on business growth among small medium enterprises. The study finally concluded that hybrid loan had significant and a positive effect on business growth among small medium enterprises.**

Keywords: **Micro-financing, SME and MFI.**

1. INTRODUCTION

Micro-finance is a source of financial services for entrepreneurs and small businesses lacking access to banking and related services. Accessing finance has been identified as key element for small and micro enterprises to thrive to build productive capacity, to compete, to create jobs and to contribute to poverty alleviation in developing countries. SMEs play a major role in most economies, particular in developing countries. Formal SMEs contribute up to 45% of total employment and up to 33% of national income (GDP) in emerging economies(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).

Statement of the problem:

SMEs are likely to secure bank loans than large firms; instead, they rely on internal or "personal" funds to launch and initially run their enterprises. 50% of formal SMEs don't have access to formal credit .The financing gap is even larger when micro and informal enterprises are taken into account .The current credit gap for formal SMEs is estimated to be US dolla 1.2 trillion the total credit gap for both formal and informal SMEs is as high as US dolla 2.6 trillion.There is challenge in how SMEs acquire loans, and the research is aimed at determining the terms and conditions of the MFI's and whether they are favorable to the SME's in acquisition of the loans. SMEs need 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 SME. Growth and development of SME's are important to both the country and the individual. For the country, they are the main source of employment in developed and

ISSN 2349-7831

International Journal of Recent Research in Social Sciences and Humanities (IJRRSSH)
Vol. 5, Issue 2, pp: (181-185), Month: April - June 2018, Available at: www.paperpublications.org

developing countries. SME's also utilize agricultural and other raw materials that would have otherwise gone to waste and they also provide the platform to leap into large scale modern production for Kenyans. For individuals, SME's provide employment and raise their standard of living. (Kamunge*et al*, 2014).

Previous studies did not focus on the improvement of access to microfinance by small medium enterprises was not sufficient unless the change or improvement is accompanied by changes in technology. To achieve this credits should be offered in a more efficient and effective way by adopting technology and should be client oriented and not product oriented. These studies instead focused on issues such as types of loans offered by micro finance institutions, financial constraints that hinder growth of SME's and effect of micro-finance services on the growth of SME's in Kenya. For example, David and Murungi (2004), only focused on the types of loans- short term and long term- offered by MFI's. Koech (2011), on the other hand studied financial factors that hinder the growth of SME's, while Cooper and Schindler, 2012),focused on the impact of MFI's on the growth of SME's. Therefore, none of these studies studied how SME's can actually qualify for and obtain this credit (Myers &Majluf, 1984).

In order to offer loans especially for businesses, large financial institutions require security in terms of collateral, usually in form of fixed assets such as land and machinery. Majority of SME's are one man businesses, hence the collateral they possess are insufficient to convince large financial institutions to issue loans to them.Small and medium-sized enterprises need finances to fund operating needs, short-term and long term investment objectives including expansion of projects and capital structure adjustments. SME's are unable to finance these requirements with internal funds because their turnover and profit levels are limited.

There might be discrimination by financial institution against the certain group based (SME'S) on social, religious and ethnic grounds. Financial institutions might also not be able to respond to certain groups of firms because the outreach may be too costly to be commercially viable. The interest rates may be too high or other lending terms might not be appropriate for certain firms (Mugenda & Mugenda, 2011).

Financial inclusion or the broad access to financial services leads to absence of price and non-price barriers in the use of financial services thus improving the degree to which financial services are available to all at a fair price. Small and mid-size organizations finance operations by applying for Biashara loans meant to support small and medium businesses, fixed-term bank loans, overdraft agreements or lines of credit. Such types of borrowing are facilitated by financial institutions such as banks, private equity firms and asset managers. Entities pay monthly instalments to lenders in accordance with debt agreements

Objectives:

1. To determine the effect of adjustable loan on the growth of SMEs at Kiambu County
2. To analyze the effect of fixed term loans on business growth among small medium enterprises at Kiambu County
3. To investigate hybrid loan on the growth of SMEs at Kiambu County

2. THEORETICAL REVIEW

Information Asymmetry Theory:

Information asymmetry implies that one party in a certain transaction whether in a job interview, a sale or any other financial transaction, has more or better information than the other party, hence affecting the outcome of the transaction. The proponents of this theory are George Akerlof, Michael Spence, and Stiglitz`s and Joseph, (2001), received a Nobel peace prize in economics for their work on information asymmetry. The concept of the asymmetrictheory was first introduced byGeorge, (1970), paper titled The Market for "Lemons": Quality Uncertainty and the Market Mechanism, where he gives the example of the automobile market.

The Pecking Order Theory:

The pecking order theory of capital structure is among the most influential theories of corporate leverage and has of recent taken the centre stage among the finance theorists. This theory is from Myers (1984) and Myers and Majluf (1984). However Myers (1984) noted that the pecking order hypothesis is "hardly new". He gave Donaldson's 1961 study of the financing practices of a sample of large corporations as an example. Donaldson had observed that: Management strongly

ISSN 2349-7831

International Journal of Recent Research in Social Sciences and Humanities (IJRRSSH)
Vol. 5, Issue 2, pp: (181-185), Month: April - June 2018, Available at: www.paperpublications.org

favoured internal generation as a source of new funds even to the exclusion of external funds except for occasional unavoidable 'bulges' in the need for funds. These bulges were not generally met by cutting dividends. Reducing the customary cash dividend payment ... was unthinkable to most management except as a defensive measure in a period of extreme financial distress. Given that external finance was needed, managers rarely thought of issuing stocks.

Financial Growth Life Cycle Theory:

The financial growth life cycle theory developed by Berger & Udell, (1998), presents firms on a size continuum, and describes the increasing array of financing options available to the firm as it grows. The theory incorporates changes in availability of information and collateral in describing sources of finance available to SMEs over time. Berger & Udell, (1998), thus conceptualize the sequencing of funding over the life cycle of the SMEs centred on information capacity and following a financial pecking order. Smaller, more informational firms are depicted to relying on initial insider finance and trade credit (Bowen, Morara&Mureithi, 2009).As firms advance along the continuum; they gain access to increased sources of external debt and equity capital. Ultimately, firms may access greater amounts of finance in public debt and equity markets. Similar to earlier approaches, the model does not specify age categories for each stage of development, nor does it consider truncation at any point in the life cycle (Wanjiku, 2009; Atieno, 2001; Atieno, 2009).

Conceptual Framework:

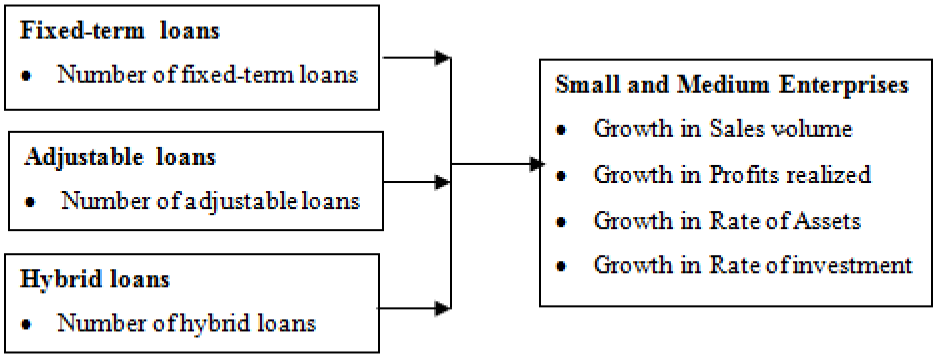

Figure 2.1: Conceptual Framework

Research gaps:

Melese (2015), noted that since adjustable loan is very crucial to the existence of microfinance, factors that affect its performance should be identified. The author notes that further research on how adjustable loan affect effect the growth of SMEs should be conducted. The literature available on adjustable loan in relation to growth of SMEs on Kenyan context is limited. The few papers that have been written on adjustable loan in Kenya have been supported mainly by reviews of papers from other countries. Furthermore, a large number of literatures have been written from a different cultural context as compared to the local culture under study in relation to fixed term loans. Kenya is still a developing economy and most of the structures have not been put in place, meaning that some of the ways proposed by some of the scholars to be the way forward may not work due to unpredictability of the situations in the country including riots, political violence, public demonstrations, and changes in trade policies, among many others (Kuria et. al., 2011).. As much as this works best in the western world, it might be difficult especially in African countries like Kenya that has many cultures and vary in the way they look at things. Literature on the fixed term loans in relation to growth of SMEs has not considered the variations of the different cultures exhibited by people who bring the same to the SMEs (Mukonyo, 2010)

3. RESEARCH METHODOLOGY

The research design used in this study was descriptive research design. The target area of this research was small and medium enterprises within Kiambu County. According to the Authorities (2014), the county has a total of 6,634 registered retail traders and 750 registered wholesale traders. The used a sample of 75 respondents. The study used stratified random sampling technique to select the sample. The study grouped the population into strata..The statistical Package for Social Sciences (SPSS) was used for data analysis purpose.

ISSN 2349-7831

International Journal of Recent Research in Social Sciences and Humanities (IJRRSSH)
Vol. 5, Issue 2, pp: (181-185), Month: April - June 2018, Available at: www.paperpublications.org

Model.

$\mathbf{Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \varepsilon}$. Where,

Y= Growth of SMES

X*1*: Adjustable loan

X*2*: Fixed term loan

X*3*: Hybrid loan

4. REGRESSION RESULTS

Coefficients of Regression Model:

Table 4.1: Significance of Independent Variables

Variables	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	2.210	.462		4.795	.000
Adjustable loan	.570	.125	.585	4.714	.000
Fixed term loans	.278	.155	.350	1.748	.000
hybrid loan	.185	.087	.280	1.651	.003

The results in Table 4.1 indicate that Adjustable loan significantly and positively influenced business growth among small medium enterprises ($\beta = 0.570$; $t = 4.714$; $p < 0.05$).This indicates that the rate charged on the loan of small and medium enterprises will primarily be driven by short term movements in the money market which in turn influence the performance of these small medium enterprises.

Further, fixed term loans have a significant and a positive effect on business growth among small medium enterprises ($\beta = 0.278$; $t = 1.748$; $p < 0.05$). This result indicates that these loans carry a higher degree of certainty as the return to the lending firm is well known at the commencement of the facility and the obligation by the borrower is fixed therefore positively influencing the of these small & medium enterprises.

Hybrid loan had significant and a positive effect on business growth among small medium enterprises ($\beta = 0.185$; $t = 1.651$; $p < 0.05$). These results indicate that with a hybrid loan; buyers have a fixed low rate on the loan for the first years of the loan term, which allows them to save money on their payments therefore positively influencing the of these small & medium enterprises.

5. CONCLUSION

The study concluded that adjustable loan significantly and positively influenced business growth among small medium enterprises. The study also concluded that fixed term loans have a significant and a positive effect on business growth among small medium enterprises. The study finally concluded that hybrid loan had significant and a positive effect on business growth among small medium enterprises

6. RECOMMENDATION

Given that the type of interest rates charged on loans (fixed and floating) dictates on the ability and flexibility of SMEs to repay loans, the study recommends that commercial banks should have a mixed interest rate policy as each type has its advantage and disadvantage.The management of lending institutions should ensure that they carry out a research on consumer needs so as to establish ideal interest rates to be charged. This will go a long way in helping them to know the needs of the consumers so as to be competitive in credit lending because most SMEs prefer being charged low interest rates hence will go for the lowest interest provider on credit facilities.The findings of the paper imply that the government should formulate policies that compel commercial banks to relax their restrictive regulations and operations on the lending interest rate which may discourage borrowing and offer more credit facilities for SMEs.

ISSN 2349-7831

International Journal of Recent Research in Social Sciences and Humanities (IJRRSSH)
Vol. 5, Issue 2, pp: (181-185), Month: April - June 2018, Available at: www.paperpublications.org

Suggestions for Further Research:

This study was conducted at a single County Government. It is recommended that further studies be conducted in other County government across the country and consider other factors that might influence growth of SMEs.Future research should include larger sample size to analyze the in-depth relationship. More cities must be added to increase scope of the study. Studies could be conducted on other sector i.e. banking or manufacturing sector to study if relationship differs in different setting. Researcher used quantitative research future researchers can take interviews to investigate the relationship further.

REFERENCES

[1] Agenor, P., Joshua A., Alexander, W. & Hoffmaister, T. (2004). The Credit Crunch in East Asia" What Can Bank Excess Liquid Assets Tell U *Journal of International Money and Finance*: 23, 27–49

[2] Alarape, A (2007). Entrepreneurship programs' operational efficiencies and growth of Small Businesses. *Journal of enterprising communities*: people and places in global economy,1(3).

[3] Amyx, C. (2005). Small business challenges. The perception problem: size doesn't matter *Washington business Journal*

[4] Atieno, R. (2001). Formal and Informal Institutions' Lending Policies and Access to Credit by Small-Scale Enterprises in Kenya: An Empirical Assessment. AERC Research Paper 111. Nairobi: *African Economic Research Consortium.*

[5] Atieno, R. (2009). Linkages, Access to Finance and the Performance of Small-Scale Enterprises in Kenya. Research Paper No. 2009/06. New York: *World Institute for Development Economics Research*

[6] Authorities, K. S.-C. (2014). *County Intergrated Development Plan.*Unpublish document from Kiambu County Authority