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Influence of Debt Equity Financing on Growth of Craft Micro Enterprises in Kenya

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***Abstract*: Craft industry contributes greatly to the economy of a country for it provides income for not only micro enterprises but also small and medium enterprises. The main objective of the study was to determine the influence of debt financing on growth of craft micro enterprises in Kenya, to determine the influence of retained earnings on growth of craft micro enterprises in Kenya. The study covered the soapstone micro enterprises registered by Tabaka Town Council and the woodcarving micro enterprises registered by Wote Town Council. This study adopted descriptive research designs. The target population for the study constituted all the soapstone micro enterprises in Tabaka Town which are registered by Tabaka Town Council, Kisii County, and all the woodcarving micro enterprises of Wamunyu Location, Machakos County, which are registered by Wote Town Council. From this population of 2334 respondents, a sample of 330 respondents was divided proportionately between the two regions according to the proportion of their craft micro enterprises under study, using stratified random sampling. The study gathered data using a semi-structured questionnaire, and the data collected were analyzed by use of descriptive and inferential type of statistics using the Statistical Package for Social Science (SPSS) version 21.The results were then summarized in tables, charts and graphs. The findings of the study revealed that debt financing has a significant influence on the growth of craft microenterprises.**

***Keywords:* Debt, Craft, Equity, Financing, Growth, Microenterprise.**

1. INTRODUCTION

Unemployment is a major problem in most countries and this has made many people to result into self employment activities which largely form the micro and small enterprises sector in the country (Stevenson, 2005). Kushnir, Mirmulstein and Ramalho (2010) define micro enterprises as a business entity which has employed between 1-9 employees, small enterprises as a business entity which has employed between 10-49 employees, and medium enterprises as a business entity which has employed between 50-245 employees.

A study by Memba (2011) praised Small and Micro Enterprises (SMEs) by disclosing their important contribution to growth of economy in Kenya as follows: promoting full productive and freely chosen employment, improving access to income earning opportunities, wealth creation leading to productive and sustainable employment quality, enhancing SMEs sustainable economic growth and ability to create change with flexibility, increase domestic savings and investment thus balancing regions and local development. The sector employs around 2.3 million people and generates around 14% of the country's Gross Domestic Product (Naserimbe, 2007).

Carpenter and Petersen (2002) as reported in Wanambisi and Bwisa (2013) argue that, firms whose financial needs exceed their internal resources may be constrained to pursue potential opportunities for growth. A study by Mateev (2010) noted

that although growth in manufacturing and service SMEs in transition economies is well explained by the traditional firm characteristics of size and age, there is no empirical evidence concerning what other specific factors may be associated with SME growth and performance in these countries in Central and Eastern Europe. Heshmati (2001) cited in Mateev (2010) found out that there existed a positive correlation between indebtedness and sales growth using data on Swedish micro and small firms. Babajide (2012) reiterated that small business enterprises in Nigeria find it difficult to access formal financial institutions such as commercial banks for funds and that this inability of the SMEs to meet the standard of the formal financial institutions for loan consideration provides a platform for informal institutions to attempt to fill the gap usually based on informal social networks. Evbuomwan, Ikpi, Okoruwa and Akinyosoye's (2012) study on preferences of micro, small and medium scale enterprises to financial products in Nigeria revealed that regardless of the immense contributions of micro enterprises (MEs) to economic growth and development not only in the developing but also in the developed world, they still face immense challenge of limited access of the investors to long term credit.

Anakoya, Fasanya and Abdulrahman (2013) found out that that loan to small scale entrepreneurs have a positive impact on the economic performance while interest rate has a negative impact on economic growth in Nigeria. Ekpe, Mat and Razak (2010) observed that most women entrepreneurs, especially in developing countries, do not have easy access to microfinance factors for their entrepreneurial activity and as such have low business performance than their men counterparts, whereas the rate of their participation in the informal sector of the economy is higher than males.

Obwori, Iravo, Munene and Kaburi's (2012) study on the effects of funding constraints in growth of small scale enterprises in soapstone industry in Kenya, found out that, collateral, bank accounts and high interest rates for loans inhibit the entrepreneurs' access to funds. Mwangi and Birundu (2015) on the effect of capital structure on the financial performance of Small and Medium Enterprises in Thika Sub-County, Kenya concluded that there was no significant effect of capital structure, asset turnover and asset tangibility on the financial performance of SMEs.

Mutinda (2014) was interested in assessing the impact of the woodcarving industry on the environment, and the study revealed that woodcarving is a source of livelihood for many families although the activity was observed to be practiced to the detriment of the environment. The study suggested the need for woodcarvers to carry out their trade in a sustainable way and also carry out afforestation and reforestation programmes.

Debt and equity are the two major classes of financing in a business. Debt holders exert lesser control over the company and earn a fixed rate of return and are protected by contractual obligations (Marcel and Sakwe, 2014). Firms choose between debt and equity as financing resources based on firm-specific factors namely, profitability, firm size, tangibility, among others; as well as macroeconomic factors like inflation rate, interest rate, economic growth (Brendea, 2012). A company's choice of capital structure determines the allocation of its operating cash flow each period between debt holders and shareholders (Chowdhury & Chowdhury, 2010). The firm's capital structure can be made optimum through among other things; minimizing the use of debt as a means of financing SMEs since often these debts are acquired by the firm at a cost in the form of interest paid on the debt. As much as the use of debt may increase the return on equity funds, but it always increases financial risk as well (Nyanamba, Nyangweso & Omari, 2013). Duan et al. (2012) observed that with the rapid development of modern market economy, in order to safeguard the comprehensive competitiveness, enterprises adjust their capital structure based on the external and internal environment.

Studies have indicated that craft industry contributes to Kenyan economy through improved infrastructure, employment, tax revenue to the government and foreign exchange. Besides, it is a major source of income for not only micro enterprises but also small and medium enterprises and also the local community (Obwori et al., 2012). However, it has been observed that in spite of their vital contribution to the growth of the economy, their growth has been very slow, if any. Inadequate capital has been perceived as one of the major reasons why there is stagnated growth among micro enterprises in various parts of the world (Obwori et al., 2012). It is for this reason that this study was done that is adopting more superior tools for data analysis so as to fill the gap.

The main objective of the study was to determine the influencing of debt financing on growth of craft micro enterprises in Kenya. The study will be pegged on Static Trade-Off Theory (TOT) which was derived by Modigliani and Miller in 1963. The TOT assumes that there are optimal capital structures by trading off the benefits and cost of debt and equity (Chen, 2013). Under the tradeoff theory of capital structure, firms determine their preferred leverage ratio by calculating the tax advantages, costs of financial distress, mispricing, and incentive effects of debt versus equity (Faulkender & Petersen,

2006). One of the benefits of the use of debt is the advantage of a debt tax shield which is associated with it. However, the cost of potential financial distress poses a threat especially when the firm relies on too much debt.

2. DEBT FINANCING

Credit facilities form an integral part of micro enterprise development. It is essential in starting, expanding or improving the productivity of an enterprise (Odero-Wanga, Mulu-Mutuku & Ali-Olubandwa, 2013). However, the results of Akingunola (2011) warned that the financial sector has dismally satisfied the financing need of the small and medium enterprises sub-sector while its micro enterprises counterpart has been completely abandoned. Debt financing refers to funds that are borrowed and must be repaid, plus interest (Torteska, 2012). There are several sources of debt financing for businesses and these include; commercial finance companies, hire purchase, share capital, and funds from SACCOs and credit unions (Scarborough, 2013). Sharma and Gounder (2011) observed that the SMEs were constrained by banks' interest rates, fees and charges, and collateral requirements thus making it hard for them to secure loan. Biswas (2014) cited lack of credit from banks as one of the major challenges faced by MSME`S in India. The study observed that on average, the banks provide on an average 50% total capital employed in fixed assets.

In a study on the impact of micro credit on small business, Akoto (2014) pointed out that, although the main reason behind loan advance to micro enterprises in the form of micro credit was to eradicate poverty by developing new markets and by promoting a culture of entrepreneurship, it was also observed that micro credit has minimal state intervention, thereby shifting the focus of attention away from the society towards individuals. Report by European Commission (2008) lamented that large financial banks have considerably reduced lending to small scale enterprises thus inhibiting their potential for growth and financial performance.

Wanjohi (2010) observed that lack of access to credit is almost universally indicated as a key problem for SME's. According to the study, this affects technology choice by limiting the number of alternatives that can be considered. Olutunla and Obamuyi (2008) narrated that the growth of SMEs is not just dependent on accessing bank loan but accessing the right size of loan at the right time. The results of a study by Abiola (2012) on the effects of microfinance on micro and small enterprises growth lamented that microfinance banks do not enhance growth and expansion capacity of micro and small enterprise in Nigeria.

Chowdhury and Chowdhury's (2010) study tested the influence of debt-equity structure on the value of shares given different sizes, industries and growth opportunities with the companies incorporated in Dhaka Stock Exchange and Chittagong Stock Exchange of Bangladesh. The findings of the study revealed that maximizing the wealth of shareholders requires a perfect combination of debt and equity. Ahmad et al. (2012) sought to investigate the impact of capital structure on firm performance in Malaysia, and found out that only short-term debt (STD) and total debt (TD) have significant relationship with ROA while return on equity ROE has significant on each of debt level. Bandyopadhyay's (2005) study on the effect of capital structure on manufacturing firms' product performance in India realized that long-term debt boosts sales growth of firms belonging to the top 50 and large business houses. However, the study further noted that long term debt is insequential for growth of sales for smaller group and unaffiliated firms.

Babajide (2012) investigated on the effects of microfinance on micro and small business growth in Nigeria, and the study revealed that access to microfinance does not enhance growth of micro and small enterprises in Nigeria, because the size of the loan is too small for any meaningful impact on small firms. Evbuomwanet al.'s (2012) study on preferences of micro, small and medium scale enterprises to financial products in Nigeria, discovered that majority of the respondents prefer loan so that they can maintain full control of their businesses. In Ghana, Abor (2005) noted that profitable firms depend more on debt as their main financing option and that this revealed a significantly positive relation between the ratio of short-term debt to total assets and ROE.

In South Africa,Clover and Darroch (2005) surveyed 44 small, medium and micro-enterprise agribusinesses in an effort to identify policies and strategies that can be adopted in order to increase the survival and growth rates of public and private sector institutions in KwaZulu-Natal (KZN), and documented that funding constraints at start-up and lack of collateral were some of the constraints that frustrate growth of the enterprises. Sekyewa (2009) analyzed the determinants of accessibility to long-term finance and its effect on growth of EIB-funded small and medium size enterprises in Uganda's

hotel industry. The study recommended that SME management and lending institutions should improve the SMEs' access to loan finance by solving the flaws in the factors influencing this access.

A research by Nyanamba et al. (2013) on the factors that determine the capital structure among micro-enterprises, found out that banks and financial institutions were the most preferred form of debt financing for the micro-enterprises.

3. RESEARCH DESIGN

Njeru (2013) defined research design as the plan showing how the problem under investigation will be solved. This study adopted descriptive research designs. The target population for the study constituted all the soapstone micro enterprises in Tabaka Town which are registered by Tabaka Town Council, Kisii County, and all the woodcarving micro enterprises of Wamunyu Location, Machakos County, which are registered by Wote Town Council. From this population of 2334 respondents, a sample of 330 respondents was divided proportionately between the two regions according to the proportion of their craft micro enterprises under study, using stratified random sampling. This stratification was done according to activities which the craft micro enterprise is engaged in (owners of wood species, quarry owners, miners, carvers, finishers, wholesalers, retailers). The study gathered data using a semi-structured questionnaire, and the data collected were analyzed by use of descriptive and inferential type of statistics using the statistical package for social science (SPSS) version 21. The results were then summarized in tables, charts and graphs.

4. FINDNGS AND DISCUSSIONS

4.1 Response Rate:

The study sought to address the objectives by administering and analyzing a questionnaire to the respondents. The study obtained a response rate of 83.03%. Mugenda and Mugenda (2003) acknowledge a response rate of 50% as being adequate, 60% and above as good, while 70% and above is rated very good.

4.2 Gender of Respondents:

The study wanted to know the distribution by gender, of the respondents involved in the study. The findings revealed the following results in figure 1:

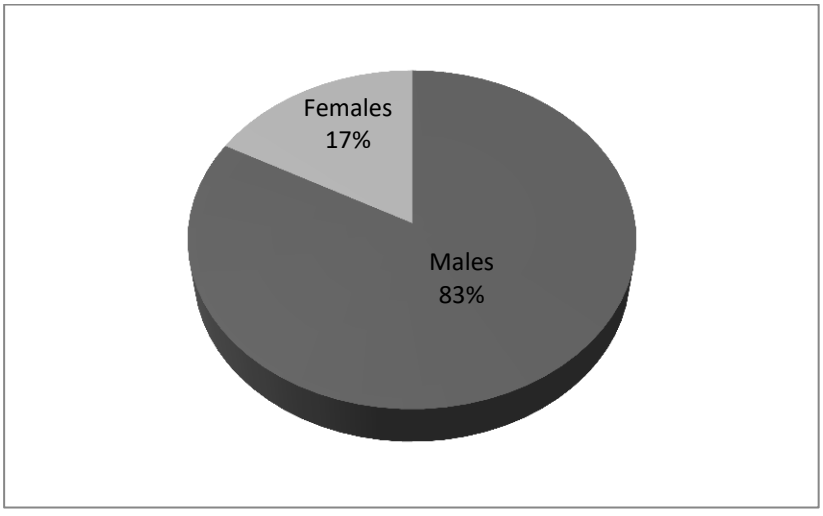

Fig. 1: Gender of Respondents

The findings in figure 1 revealed that gender of craft micro entrepreneurs is unfairly skewed in favour of men in the sense that 83% of the respondents were males while only 77% of the respondents were females. This finding implies that the industry is dominated by males. This could be due to the fact that traditionally, carving was a male activity and hence most women see it as a preservative of men to date. Similar findings in gender imbalance had been observed in Obwori et al. (2012) which found out that, small scale enterprises in soapstone industry were dominated by males who constituted 61% against 39% females; and attributed this to male dominance accompanied by the cultural notion that soapstone carving was a reserve of men.

4.3 Respondents' Age:

The study sought to know the distribution by age, of the respondents involved in the study. The study yielded the results in table 1.

Table 1: Respondents' Age

Age	Frequency	Percentage
Below 18 years	21	7.7
between 18 and 35 years	65	23.7
between 36 and 45 years	149	54.4
between 46 and 55 years	37	13.5
over 55 years	2	0.7
Total	**274**	**100.0**

As table 1 summarizes, the study revealed that 7.7% of the respondents were below 18 years old; 23.7% of the respondents were aged between 18 and 35 years old, 54.4% of the respondents were aged between 36 and 45 years old, 13.5% of the respondents were aged between 46 and 55 years while only 0.7% of the respondents were over 55 years old. This implies that majority of the respondents are of the age between 18 years and 45 years. The fact that there were few respondents of the age below 18 years indicates that the profession does not attract under-age persons. It could also be due to the free primary education that has seen most pupils who would have otherwise dropped out of school continue with their education. The study also noted a small percentage of respondents who were over 55 years of age probably because most of the enterprises under study were labour intensive thus the aged could not easily cope.

4.4 Enterprises' Need for Debt Financing:

The study sought to establish whether the enterprises had borrowed money from financial institutions at some point in time, and the results were as indicated in figure 2:

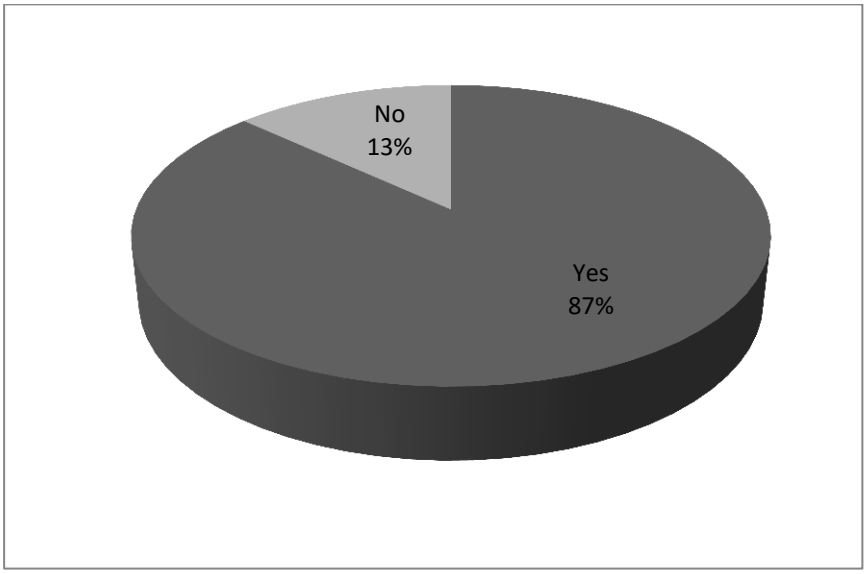

Fig. 2: Enterprises' Need for Debt Financing

From figure 2, the research realized that 87% of the respondents had borrowed from financial institutions at some point while only 13% of the respondents had not sought for financing from financial institutions at any given time. The reason why the respondents had sought financing from financial institutions could be due to their inability to raise sufficient capital from their net income since, as observed by Obwori et al. (2012), the net income from the craft microenterprises was mainly used to support non-business activities like family upkeep. It could also be because of the need for business expansion. The finding underscores those of Wanambisi and Bwisa (2013) who stated that only 41.7% of the enterprises in Kitale Municipality had sought financing.

4.5 Distribution of Borrowing from Commercial Bank loans:

The distribution of average borrowing from Commercial Bank loans was as indicated from table 2.

Table 2: Average Borrowing from Commercial Bank loans

Amount	Frequency	Percentage
Less than 20,000	269	98.2
20,001-40,000	3	1.0
40,001-60,000	1	.4
60,001-80,000	1	.4
80,001-100,000	0	.0
Over 100,000	0	.0
Total	**274**	**100.0**

The results shown in table 2 show that, only five respondents borrowed over Ksh. 20,000 from Commercial Bank loans over the span of the three years (2013-2015). This may lead to a conclusion that majority of the respondents in this study did not get any loan either because they did not have collateral, they feared rejection, they lacked guarantors or they did not meet the condition for group saving, and this confirms the study by Wanambisi and Bwisa (2013). The majority of the respondents borrowed between Ksh. 20,001 and Ksh. 40,000. This study is in full support of Kadiri (2009) whose study concluded that enterprises in Nigeria do not get any financing from commercial banks in Nigeria, Mukiri (2008) who had observed that only 7.8% of micro entrepreneurs access bank credit annually, and Njuguna (2015) who reported that only 4.6% of entrepreneurs got funds from commercial banks.

4.6 Distribution of Borrowing from SACCOs:

The distribution of average borrowing from SACCOs was as indicated from table 3.

Table 3: Average Borrowing from SACCOs

Amount	Frequency	Percentage
Less than 20,000	269	97.1
20,001-40,000	3	1.1
40,001-60,000	2	.7
60,001-80,000	3	1.1
80,001-100,000	0	.0
Over 100,000	0	.0
Total	**274**	**100.0**

The results in table 3 show that only 8 respondents borrowed from SACCOs over the span of the three years (2013-2015). Majority of the respondents (98.2%) did not borrow a cent from the SACCOs. This could either signal that the enterprises are contented with the current capital base; or that they are unable to attract more capital from these sources owing to the stringent requirements and this could also be as a result of the small number of SACCOs in the County. The low percentage number of respondents taking loans could also be due to the fact that they do not undertake activities which guarantee need for external financing. These findings are coherent to those obtained by Lemuel (2009) discovered that between 1-2% of small businesses in Nigeria borrowed from banks and other financial Institutions, and that of Njuguna (2015) who reported that only 8.05% of the respondents obtained financing from SACCOs while 4.6% got funds from commercial banks.

4.7 Reasons for Seeking Debt Financing:

Respondents were asked to indicate the purpose for which debt financing was needed. The findings were as indicated in figure 3.

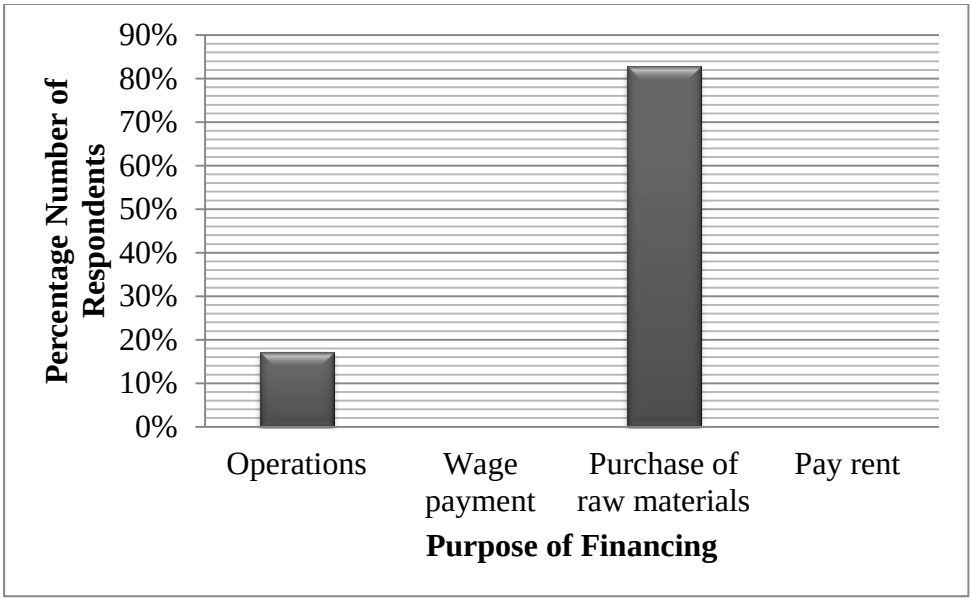

Fig. 3: Need for Debt Financing

Figure 3 shows that 82.8% of the respondents sought debt financing in order to purchase raw material while only 17.2% of the respondents sought debt funds so as to finance their operations. This finding contravenes that of Eriotis et al. (2007) who noted that Greek firms rarely use debt financing to offset the financial needs of their business.

4.8 Effect of Debt Financing on Growth of Craft Microenterprises:

The study wanted to know the relationship between debt financing and growth of craft micro enterprises. For this reason, a regression of debt financing on the growth of craft micro enterprises was done and the findings produced the model summary shown on table 4. The table indicates that the value of R square for debt financing is 0.181. This means that, in isolation, debt financing alone accounts for 18.1% of all growth of craft microenterprises, with the remaining 81.9% of the growth of craft microenterprises being accounted for by other factors. The value of R (0.425) was a clear indication that there was a positive relationship between debt financing and growth of craft micro enterprises. Although the finding of this study contradicts that of Babajide (2012) who contended that access to microfinance does not enhance growth of micro and small enterprises; it supports that of Abor (2005) which contended that short term debts significantly and positively influenced the performance of a firm.

Table 4: Model Summary for Debt Financing

R	R Square	Adjusted R Square
.425[a]	.181	0.086

In order to test the null hypothesis which stated that 'debt financing has no significant influence on the growth of craft micro enterprises", an Analysis of Variance test was used. The findings from the ANOVA were as presented on table 5.

Table 5: ANOVA[a] for Influence of Debt Financing on Growth of Craft Micro Enterprise

		Sum of Squares	df	Mean Square	F	Sig.
Debt financing	Regression	318.85	5	63.77	5.17	.026[b]
	Residuals	3318.01	269	12.33		
	Total	**3636.86**	**274**			

a. Dependent variable: Growth of craft micro enterprise

b. Predictors: (Constant), Debt financing

The p-value from table 5 was 0.026 and this was found to be less than the critical value (0.05) and this implied that, at 5% significance level, debt financing has significant influence on the growth of craft micro enterprises. The study determined the significance test result for debt financing. The regression equation was to be presented in the form;

$$Y = \beta_O + \beta_1 DF + \varepsilon$$

Where;

β_0- Coefficient of intercept

DF-Debt financing

ε-Error term

Table 6 presents the table of coefficients for the linear regression which led to model (1) below:

$Y = 0.218 + 0.193DF$……(1)

Table 6: Significant Test Results for Debt Financing

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	.218	.126	.141	7.245	.000
DF	.193	.072	. 148	8.248	.000
a. Dependent Variable: Growth of Microenterprise					

Equation (1) shows that for every 1 unit increase in debt financing, growth of craft micro enterprise is predicted to have an increase by 0.193 units and that, if no debt financing is used, the enterprise will be having growth of 0.218 units.

The study determined the significance test result for the various constructs of debt financing so as to formulate a regression model of the form;

$$Y = \beta_O + \beta_1 CF + \beta_2 SL + \varepsilon$$

Where;

β_0- Coefficient of intercept

CF- Commercial Bank loans

SL-SACCO loan

ε-Error term

The results were as shown on table 7.

Table 7: Significant Test Results for Constructs of Debt Financing

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
	(Constant)	.027	.009		3.221	.003
	CF	.016	.005	.101	5.121	.000
	SL	.011	.009	.105	3.549	.000
a. Dependent Variable: Growth of Microenterprise						

From the results in table 4.7, the following regression model was obtained

$Y = 0.027 + 0.016CF + 0.011SL$…….(2)

Equation (2) shows that for every 1 unit increase in funding from Commercial Bank loans leads to 0.016 units increase in growth of the microenterprise; and that one unit increase in use of funds from SACCO loans lead to 0.011 units increase

in growth of craft micro enterprise. However, if no debt financing is used, the growth rate of the enterprises will be 0.027 units. Since all the two variables had p-values less than 0.05, it led to the conclusion that they were all significant in the model.

5. CONCLUSION

From the above results, it can be noted that Commercial finance companies and SACCOs are the major sources of debt financing that had are preferred the craft micro enterprises. This finding contradicts that of Wanambisi and Bwisa (2013) who lamented that, despite the efforts of microfinance institutions to take microfinance services within the reach of poor people and MSEs that have not benefited from the conventional formal financial system, growth and expansion of MSEs sector had not shown any sign of growth and expansion.

6. RECOMMENDATIONS

Based on the above conclusions, the study recommends that financial institutions should lessen their restrictions on the requirements for one to qualify for a loan, for instance, the need for collateral, because the micro enterprises hardly have collateral, while this is deemed to be one of the requirements for a business to qualify for a loan. The government should also sensitize the proprietors in this industry on book keeping, since it was observed that majority of the respondents under investigation did not have proper records regarding their businesses' financial progress. This is deemed important in the sense that some of the financial institutions demand financial records and/or bank statements so as to analyze before concluding on whether or not to award a loan.

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