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

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***Abstract*: Micro enterprises together with small and medium enterprises provide employment and income to many people in Kenya. The main objective of the study was to establish the influence of external equity financing on growth of craft micro enterprises in Kenya. The target population for the study constituted all the 2334 craft micro enterprises. The sample frame constituted all the soapstone micro enterprises operating within Tabaka Town and all the woodcarving micro enterprises registered by Wote Town Council. The study used a sample of 330 craft micro enterprises drawn using stratified sampling technique. Data were gathered data using a semi-structured questionnaire after testing it for reliability and validity, and then analyzed by use of descriptive and inferential type of statistics. The ANOVA and multiple regression analysis were used to analyze the data. The findings of the study revealed that, external equity financing (p-value 0.000) has a significant influence on the growth of craft microenterprises. The study recommended that the government should sensitize and encourage the entrepreneurs on to use funds from friends and family members since these are cheap sources because they do not attract interests.**

***Keywords:* Craft, External equity, Financing, Growth, Microenterprise, Tabaka.**

1. INTRODUCTION

Lack of employment alternatives has made many people to result into self employment activities which mainly comprise the micro and small enterprises sector in the country (Stevenson, 2005). Several studies have defined micro, small and medium enterprises in different ways. For instance, whereas Kushniret, Mirmulstein and Ramalho (2010) define micro, small, medium and large enterprises as follows: Micro enterprises: 1-9 employees, small enterprises: 10-49 employees, and medium enterprises: 50-245 employees; Stevenson (2005) defines micro enterprise as a business entity having not more than ten employees including the owner, while a small enterprise is the one having eleven to fifty employees.

Micro enterprises together with small and medium enterprises contribute immensely to the economy of most countries in the world (Chimuneka & Rungani, 2011). Lemuel (2009) observed that micro enterprises mainly comprises of uneducated but dynamic sole ownership with low technology, they are engaged in retail, arts and crafts, textiles, services (for example, Salons, tailoring) and have few links with donor sponsored providers.

A study by Daskalakis, Jarvis and Schizars (2013) observed that micro and small enterprises constituted 99.6 per cent of the total number of firms operating in Greece and that it is responsible for about 40 percent of the exports and 45 per cent of the total manufacturing output (Biswas, 2014). Further analysis by Chimucheka & Rungani (2011) realized that in South Africa, SM 74% of South Africans active in the economy are employed by SMMEs. Nasirembe (2007) found out that the MSE sector in Kenya employs around 2.3 million people and generates around 14% of the country’s Gross Domestic Product (GDP). Of these, women’s ownership account for 48 percent of the micro-, small-, and medium-size enterprises in Kenya majority of which are in the informal sector in rural areas (Kyalo, 2013).

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The main objective of the study was to determine influence of external equity financing on growth of craft micro enterprises in Kenya. This study w**as** based on the Market Timing Theory (MTT) which was introduced by Baker and Wurgler in 2002. The theory states that firms prefer external equity when the cost of equity is low, and prefer debt financing when the cost of external equity is high (Huang & Ritter, 2004). The intention of market timing is to exploit temporary fluctuations in the cost of equity relative to the cost of other forms of capital (Baker & Wugler, 2002). The MTT will lend a hand to this study in judging whether or not craft micro enterprises prefer external equity when the cost of equity is low, and prefer debt financing when the cost of external equity is high.

2. EXTERNAL EQUITY 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

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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, Nyangweso and Omari (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

A sample of 330 respondents was selected by stratified random sampling and purposive sampling technique from the population of 2,334 craft micro enterprises operating within Tabaka Town and Wamunyu Location. The study grouped the micro enterprises into two strata based on region, and then each stratum was stratified further according to the activities which the craft micro enterprise is engaged in (owners of wood species, quarry owners, miners, carvers, finishers, wholesalers, retailers), and then a sample was randomly selected from each stratum. Purposive sampling was used to distinguish craft micro enterprises from small, medium and large craft enterprises. The researcher requested for lists of craft micro enterprises that are registered by issue of business license, by Tabaka Town Council and Wote Town Council, which were used to identify the relevant craft micro enterprises to be used in the study. The sample of 330 respondents was divided proportionately between the two regions according to the proportion of their craft micro enterprises under study as follows: Thus, 160 respondents were selected from Tabaka craft micro enterprises, and 170 respondents from the wood carvers of Wamunyu location. The study gathered data using a semi-structured questionnaire and analyzed using the Statistical Package for Social Science (SPSS) version 21. The relationship between external equity financing and growth of craft micro enterprises was presented as follows:

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

Where;

β_0-Coefficient of Intercept

EE-External equity financing

ε-Error term

4. FINDNGS AND DISCUSSIONS

4.1 Response Rate:

The research instrument which was a questionnaire was administered to 330 respondents. The study received 274 questionnaires, which represented 83.03% response rate. Babbie (2004) cited in who also asserted that return rates of above 50% are acceptable to analyze and publish, 60% is good and 70% is very good. This means that the response rate for this study was very good.

4.2 Enterprises' Need for Financing:

The study sought to establish whether the enterprises had needed some financing at some point in time. The results were as indicated in figure 1:

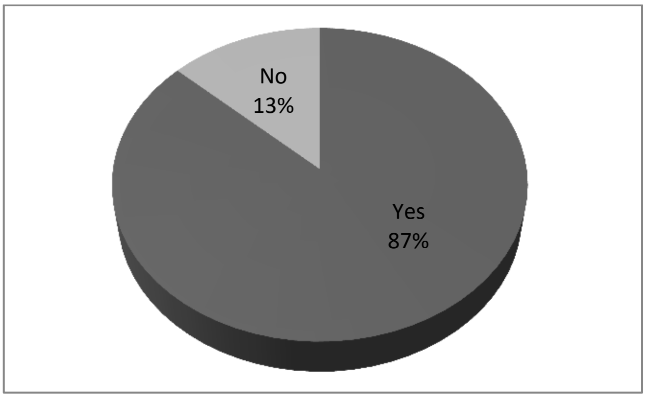

Fig. 1: Enterprises' Need for Financing

From figure 1, the research realized that 87% of the respondents had shown the need for financing at some point while only 13% of the respondents had not sought for financing at any given time. This study supports that of Dube (2013) which realized that 75% of small businesses in Zimbabwe had shown the need for financing; and this was achieved through debt financing.

4.3 Respondents' Borrowing of External Financing:

The study sought to find out whether their respective enterprises under study have borrowed from external sources of finance. The findings are documented in table 1.

Table 1: Analysis of Use of External Sources of Finance

	Frequency	Percentage
Yes	30	10.9
No	244	89.1
Total	274	100.0

As table 1 shows, 89.1% of the respondents had never sought some form of external finance while only 10.9% of the respondents had sought some form of financing. The reason why majority of the respondents had never tried to solicit external financing could be due to fear of inability to repay, lack of collaterals or guarantors. It could also be due to general notion that they cannot be given loan even if they applied owing to the small nature of their businesses. This finding collaborates with Osie-Assibey (2010) whose study found out that 90% of the micro and small enterprises did not seek any credit to finance their working capital needs.

4.4 Sources of External Equity Financing:

The study wanted to know the most preferred source of external equity financing for the microenterprises under study. The study revealed the findings in figure 2.

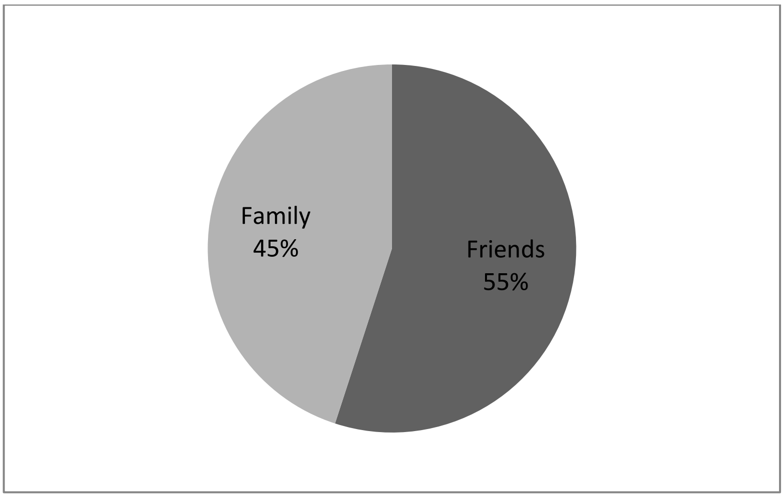

Fig. 2: External Sources of Finance

As figure 2 depicts, majority of the enterprises (55%) used funds from friends as the external source of financing while 45% of the enterprises used funds from family members as their source of external financing. This shows that both sources of financing are almost equally preferred as the source of external financing. This contradicts the findings of Osie-Assibey (2010) and Huang Song (2002) who noted that majority of the entrepreneurs in Ghana and China respectively used self-finance as the main source of start-up capital for these microenterprises.

4.5 Respondents' Use of External Finance:

Respondents were asked to disclose the amount of finance they had used from external sources of finance. Some selected sources of finance were provided on a table and the respondents were required to indicate the amount they had got from them. The table 2 below shows the findings.

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4.6 Effects of External Financing on the Growth of Enterprises:

The study sought to determine the effect of external financing the growth of enterprises. The findings were as presented in table 2.

Table 2: Effect of External Finance on Growth of Craft Micro Enterprises

Effect	Frequency	Percentage
Improved the business	248	90.5
no effect	20	7.3
Retarded the business	6	2.2
Total	**274**	**100.0**

The findings in table 2 shows that 90.5% of the respondents felt that external financing improved the business, 7.3% of the respondents opined that external financing has no effect on growth of enterprise while the remaining 2.2% of the respondents felt that external financing retarded the growth of the business. This finding rhymes Dube's (2010) study which contented that 60% of the enterprises in Zimbabwe had witnessed some growth as a result of the external financing.

4.7 Effect of External Equity Financing on Growth of Craft Microenterprises:

The study sought to determine the link between external equity financing and growth of the craft micro enterprises. Table 3 presents summary of regression model result obtained.

Table 3: Model Summary for External Equity Financing

R	R Square	Adjusted R Square
.592[a]	.351	0.081

Table 3 shows that there is a positive linear relationship (R=0.592) between external equity financing and growth of craft microenterprises. The table also shows that 35.1% of the growth of craft microenterprises is accounted for by the external equity financing. The ANOVA results from regression analysis were as shown on table 3.

Table 4: ANOVA[a] for the Influence of External Equity Financing on Growth of Craft Micro Enterprise

		Sum of Squares	df	Mean Square	F	Sig.
	Regression	120.85	5	24.17	2.11	.000[b]
External equity financing	Residuals	3080.05	269	11.45		
	Total	**3200.09**	**274**			

a. Dependent variable: Growth of craft micro enterprise

b. Predictors: (Constant), External equity financing

The above results on table 4 shows that the p-value for ANOVA (0.000) is less than the critical value of 0.05. This implies that, at 5% significance level, external equity financing has influence on the growth of craft micro enterprises. The study further determined the significance test result for external equity financing and the results were as shown on table 4.

Table 5: Significant Test Results for External Equity Financing

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	.141	.153	.122	6.413	.000
EE	.246	.042	.164	7.776	.000

a. Dependent Variable: Growth of Microenterprise

The findings in table 5 led to the formation of the regression model (6) below:

$Y = 0.141 + 0.246\ EE$……………………………………(1)

The study run a significance test result for external equity financing constructs so as to determine the regression equation which was to be presented in the form;

$Y = \beta_0 + \beta_1 FR + \beta_2 FF + \varepsilon$

Where;

FR-Funds from friends

ε-Error term

The analysis revealed the results in table 6.

Table 6: Significant Test Results for External Equity Financing

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
	(Constant)	.013	.009		3.113	.000
	FR	.035	.015	.120	4.207	.006
	FF	.028	.014	.156	3.105	.021

a. Dependent Variable: Growth of Microenterprise

The findings in table 6 led to the formation of the regression model (7) below:

$\mathbf{Y = 0.013 + 0.035FR + 0.028FF}$**……………………………(2)**

Model (2) shows that for every 1 unit of funds from friends injected to the microenterprise leads increase in growth of microenterprises by 0.035 units; while an increase of funds from family finance into the microenterprise by one unit resulted in growth of microenterprises under study by 0.028 units. However, if no external equity financing is used, the growth rate of the enterprises will be 0.013 units.

5. CONCLUSION

The study concludes that, it is not easy for craft micro enterprises to secure external finances when need arises. The study recommends that the government should sensitize and encourage the entrepreneurs on to use funds from friends and family members since these are cheap sources because they do not attract interests. Besides, they do not dilute ownership structure of the enterprise. It can also be observed from the study that, external equity financing has a significant influence on the growth of craft microenterprises.

6. RECOMMENDATIONS

Based on the above conclusions, the study recommends that the government should sensitize and encourage the entrepreneurs on to use funds from friends and family members since these are cheap sources because they do not attract interests. Besides, they do not dilute ownership structure of the enterprise

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