The Relationship between Small Scale Enterprises Performance and Access to Credit from Microfinance Institutions in Mount Elgon Constituency, Kenya

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Abstract
The purpose of this study was to examine the factors that affect access to credit by SSE s in Mt. Elgon District. The study addressed four objectives namely; establish the relationship between owner/manager characteristics, business characteristics, SSE performance and belonging to a social group and access to credit from MFIs. The study null hypotheses were derived from the objectives. The study adapted a descriptive survey design. This design was used to determine the nature of an existing state of affairs within the population. The target population was all small scale enterprise operations in Mt. Elgon district. Only SSEs that had existed for more than 2 years were considered totalling around 1200. The target population was stratified into homogenous categories as wholesalers, retailers, and restaurant and service delivery. Samples of 120 SSEs were randomly and proportionally drawn from the population strata. A structured questionnaire was used to collect data. An interview schedule was used to solicit for in depth information from key informants pertaining access to credit by SSEs. Data was summarized and presented using percentages, means and standard deviation chi-square and t- tests were used to establish relationships between categorical and continuous data respectively. Based on the findings of the study, it was concluded that owner characteristics, business characteristics, group membership affects access to credit by SSEs in Mt. Elgon constituency. Owners /mangers should acquire skills adequate to drive the performance of their businesses. The study recommends that SSE owners should be encouraged to form groups which provide social capital that attracts MFI service easily.

Keywords: Small Scale Enterprises, Long Term Debt, Medium Term Debt, Non-Bank Financial Institutions, Micro Finance Institutions.

1.0 Introduction

The role of Micro and Small-scale Enterprises (MSEs) in socio-economic development as a means for generating sustainable employment and income is increasingly recognized. In developing countries, the informal sector is a large source of employment and income, particularly for the urban population. The informal employment, outside of agriculture, is defined as employment that comprises of both self-employment, in the informal enterprises, and wage employment, in the informal jobs, without secure contracts, worker benefits, or social protection and represents nearly half or more of the total non-agricultural employment in all regions of the developing world (Akabueze, 2002),. The formal employment by MSEs ranges from 48% in North Africa to 51% in Latin America, 65% in Asia, and 72% in sub-Saharan Africa (IFC, 2001). In Ethiopia, about half of the urban workforce is engaged in the informal sector and Addis Ababa nearly accounts for about 40% of the total operators in micro enterprise activities.

In Africa the World Bank approved two micro and small scale projects in 1975 for Cameroon, and Cote d'Ivoire. Elsewhere three others were approved in Korea, Philippines and Columbia (Leira, et al, 1996). Since then the participation of SSEs in income generating activities has increased as more people venture into the informal sector to garner additional income for their families. They rely on a variety of funding sources for start-up finance, equity finance, and expansion finance. According to Lauren (1998), MSEs rely on personal savings, savings or group credit society, money lender or credit organizations, loans or gifts from friends or family, bank or promotional agency loans, co-investor or parent company, profits from another business, supplier credit and other sources.

Micro and Small Enterprises (MSEs) which are defined broadly as income generating activities that employ between 1-50 persons, play a significant role in the development process of Kenya (Government of Kenya 2005). This arises from the observation that during the early stages of economic development, these enterprises manifest unique opportunities for wealth and employment creation. In 1999 it was estimated that there are about 1.3 million MSEs in Kenya (International Centre for Economic Growth et al. 1999). Four years later, MSEs were estimated to employ 5.1 million people (Government of Kenya 2003). Moreover, MSEs are thought to be central in promoting an entrepreneurial culture and technological adaptation. The development of the sector is therefore crucial in reducing poverty in Kenya. According to the Government of Kenya (2003), the sector contributed over 50 per cent of new jobs created in the year 2005.

Micro-enterprises are those that employ 10 or fewer workers and small-scale enterprises are those that employ 11-50 workers. MSEs are defined in three criteria, the first as those that employ workers less than 10 to less than 50, secondly as those that are not registered and do not comply with legal obligations concerning safety, taxes and labour laws and thirdly as their limited amounts of capital and skills per worker (Lisa et al. 1995).

According to Kimuyu and Omiti (2000), Micro and Small Scale Enterprises are reputed for being behind most of the social-economic transformation in Kenya where they have contributed a great deal to the development process through employment and wealth creation. Some commercial banks in Kenya have a number of schemes targeting the MSEs. The schemes range from subsidized credit guaranteed by donors. Other actors include Non-Bank Financial Institutions, Development Financial Institutions, NGOs, Government of Kenya and Rotating Saving and Credit Association (ROSCAS) (Wanyiru 1998). However despite all these micro finance lenders, limited access of SSEs to credit and financial services is one of the biggest challenges facing SSEs in Kenya and the current trends show that this has persisted (Dondo, 1995).

The problem of credit access explains why MSSEs are generally undercapitalized and face operational difficulties in accessing credit and pursuing corporate goals (Macharia, 1998). According to a recent SSEs Baseline Survey conducted in Kenya, 6% of SSEs apply for and use credit. The rest are the majority and it is not clear how they meet their investment and working capital needs (Peter, et al 2000).The enterprises that sought credit were given modest amounts and this meant the enterprises were involved in low level activities. Other factors that limit level of credit used by SSEs include the ceiling fixed by NGOs and government credit programmes, Kimuyu et al (2000).

MSEs are generally undercapitalized, suggesting major operational difficulties in accessing credit and pursuing corporate goals. Kimuyu and Omiti (2000) observe that 18.4% of the MSEs in Kenya cite access to credit as their second most severe constraint after market access. Further the 1999 National Baseline survey (International Centre for Economic Growth et al. 1999) indicates that 70% of the MSEs in Kenya require loans that do not exceed Kshs. 20 000 (US$ 285) while 96.3% do not require loans exceeding Kshs.100 000 (US$ 1428). Ondiege (1996) demonstrated that access to credit is associated with improved performance of MSEs in Kenya.

Lack of credit is the most severe problem faced by MSEs. Most of the MSEs use own funds and family resources as source of initial and additional capital Although most often MSE entrepreneurs acquire their capital from their own savings or from family members, they also resort to traditional banking (merry go round) and table banking to meet their capital requirements. Considering the very low incomes and savings rate in the country, MSEs fall back on these sources of credit out of desperation, the reason why they close down after a few month in business Nevertheless, as a result of their weak financial base, MSEs are regarded as high risk areas and as much do not succeed in attracting enough loans (Lisa et al,1995).

Lisa et al. (1995) cite Africa’s slow pace of growth and underdevelopment as reason for low productivity growth. Although several underlying factors have been identified for this in the region, financial constraints particularly among micro and small enterprises (MSEs) have received much more attention in recent times. This is because evidence abounds that lack of finance stifles innovations, investments in physical capital and new technology that are likely to stimulate productivity growth (Wolf, 2007;). Moreover, the significant role MSEs play in reducing poverty through income and employment of the vast majority of labur force in Africa is widely acknowledged. There are various other financial challenges that face small enterprises. They include the high cost of credit, high bank charges and fees.

MSSEs are constrained by a number of factors in accessing credit. Omboi and Wangai (2011) explored factors that influence the demand for credit among small scale investors and observed that the young tend to save or borrow more for investment while the old may be less inclined to save and borrow. Omboi and Wangai (2011) revealed that the education level of a small-scale entrepreneur has a positive influence on his/her demand for credit from formal financial institutions. Enterprises with more educated owners can be expected to have more access to institutional credit than enterprises with less educated owners. This is because less educated owners tend to have difficulty with application procedures and expect to be rejected. Furthermore, better educated managers are more likely to have managerial skills in finance, marketing production, and international business that would lead to the firm’s growth (Kumar and Francisco, 2005).

Age of an individual is positively related to the decision to apply for credit and the amount of credit applied for (Mpuga, 2004). Schell,(1996). claim that size and age limit a firm’s access to finance has been contested by other researchers. The level of income of a small-scale entrepreneur is an important component that determines demand for credit. Further, entrepreneurs who belong to a support group borrow more than those who do not (Omboi & Wangai, 2011).

Kimuyu, (2001) shows that the MSSEs sector is very vibrant as evidenced by increased investment and enterprise growth. It is therefore important that the sector is developed so that it can further reduce poverty in Kenya. It is this need to promote MSSEs that has inspired the need for this study whose main aim is to determine the factors that influence credit financing for Micro and Small Scale Enterprises in Kenya.

1.1 Statement of the Problem

The small and micro enterprises (MSEs) play an important role in the Kenyan Economy. Despite interventions from MFIs and mainstream commercial banks, the majority of MSEs, particularly at start-ups, are still severely constrained. Financial constraint remains a major challenge facing SMEs in Kenya (Wanjohi & Mugure, 2008, Kimuyu &Omiti ,2000, Omboi & Wangai, 2011)). Thus, they are forced to often rely on limited household savings (self-raised financing), remittances or even donations from charitable organizations as well as sometimes on informal finance, which are known to charge exorbitantly high interest rates (Schell, 1996).). Despite their significance, past statistics indicate that three out of five businesses fail within the first few months of operation due to capitalization (Kenya National Bureau of Statistics, 2007).It is in this context that the study seeks to examine the factors that may have contributed to low capitalization with emphasis being placed on credit financing. Therefore, the overall objective of the study will be to examine the factors that affect credit financing of SSE’S: a survey of small scale enterprises in Mt Elgon District.

1.2 Research Objective

1. To establish the relationship between SSE performance and access to credit from formal microfinance institutions.

2. To establish the relationship between SSE characteristics and access to credit from formal microfinance institutions.

1.3 Hypotheses

Ho_1: There is no significant statistical relationship between SSE performance and access to credit from formal microfinance institutions.

Ho_2: There is no significant statistical relationship between SSE characteristics and access to credit from formal microfinance institutions.

2.0 Literature Review

2.1 The Resource Based Theory

The resource-based theory is predominantly used to analyze strategic resources that are available to firms. Resources include all assets, capabilities, organizational processes, firm attributes, information and knowledge that are controlled by firms and which enable them to conceive of, and implement strategies that improve efficiency and effectiveness (Horward ,1995). Resources are either property-based or knowledge-based (Horward,1995). In this respect, property-based resources are tradable and non-specific to the firm while knowledge-based resources are the ways in which firms combine and transform tangible input resources. Therefore, knowledge-based resources may be important in providing sustainable competitive advantage (Horward, 1995) Age and education are two common sources of knowledge-based resources, which influence access to bank credit (Kimuyu and Omiti 2000). Other, sources of knowledge-based resources that have the potential to influence access to bank credit include family business history, entrepreneurial experience, industry specific know-how, training and social capital (Schell, (1996).).

The above-mentioned characteristics are individually necessary, but not sufficient conditions for attaining superior outcomes. The organization of these resources is very important (Dorothy *et.al.*, 1998)).. The organizing activities in MSEs include cognitive aspects such as planning, decision making or failure considerations and actions such as resource acquisition. Entrepreneurial orientation is a construct that has been used previously to measure the extent of organization in small enterprises (Dorothy *et.al.*, 1998)).. Entrepreneurial orientation refers to a firm's decision-making styles, methods and practices that lead to new entry (Horward,1995) It reflects three organisational level behaviours namely: risk-taking, innovativeness and proactiveness (Covin and Slevin 1986). When accessing bank credit is considered as new entry, entrepreneurial orientation should be expected to be its direct determinant. Studies that examine this proposition are not readily available.

The fundamental principle of the resource-based theory is that the basis for a competitive advantage of a firm lies primarily in the application of the bundle of valuable resources at the firm's disposal. This requires resources to be heterogeneous in nature and not perfectly mobile (Dorothy *et.al.*, 1998)). It also means that valuable resources should neither be perfectly imitable nor substitutable without great effort. If these conditions hold, the firm's bundle of resources can assist the firm to have unique dispositions that lead to superior outcomes.

The important lesson of the resource-based theory in small business finance is that it allows the identification of the resources associated with successful and unsuccessful access to bank credit. Further, it provides adequate logic or explanations underlying key propositions. It also helps to identify the type of relationships between its key concepts. Thus, it allows for a comprehensive and integrated framework that can be used to identify effective interventions

2.2 MSE owner Education and Access to Micro Credit

The findings of Omboi and Wangai (2011) revealed that the education level of a small-scale entrepreneur has a positive influence on his/her demand for credit from formal financial institutions. When the education variable interacts with other factors, the odds in favour of entrepreneurs with higher educational level were 1.2 times greater compared to those with less education (primary level and those with no education background). The results are significant at 10% level of significance. This research finding may be explained by the fact that operations of formal financial institutions are tailored to offer credit services to formally registered businesses, which meet criteria such as proper maintenance of books of accounts and a verifiable asset base.

Mpuga (2004) analyzed demand for credit in rural Uganda. Using the household surveys data for 1992/93 and 1999/2000, a probit estimation model on demand for credit showed that individual characteristics have important implications on demand for credit. Age of an individual is positively related to the decision to apply for credit and the amount of credit applied for. Following the life-cycle hypothesis, the young and energetic individuals with ambitions to earn higher incomes are expected to be more active in terms of saving in order to accumulate wealth.

The formal segment of Kenya's financial sector is dominated by a few Commercial Banks which do not have a track record of lending to small scale enterprises. To fill this gap the government backed initiatives such as the Small Enterprise Finance Company, Kenya Industrial Estates and other alternatives to formal banks .When credit is advocated as the primary remedy for low level productivity or when loans are used to stimulate growth these strategies lack structures for locking out risky borrowers. Consequently many borrowers don't pay thereby drying the pool of funds for lending, an exit problem evident in Kenya. Savings and Credit Co-operatives (SACCOs) and Non-Bank Financial Institutions (NBFIs) grew quickly to fill the gap created by commercial banks but served only salaried employees for whom borrowing and lending entitlements were clear. (Kimuyu, *et al* 2000).

2.3 Firm Size and Age

The claim of Horward (1995) that size and age limit a firm's access to finance has been contested by other researchers. Horward (1995), for example found that size may be merely an indicator in decisions relating to selecting between insider financing and longer-term debt/public equity (LTD/PE), and may not even predict the use of venture capital/medium-term debt (VC/MTD) versus LTD/PE. The authors also show that younger, not older firms, contrary to the proposal of Horward (1995), are more likely to use PE/LTD than VC/MTD; the paradox can be explained perhaps by the lack of adequate growth in older firms. Birch and others (1999) agree that it is the younger growth firms that may be able to secure the more attractive financing forms. Unlike the case of their larger counterparts, financing for smaller enterprises is anything but standardized; funding sources for small enterprises may range from internal injections to debt financing. Horward (1995) contend that, since small enterprises may be characteristically different, predicting financing sources based on firm characteristics may not be very useful. Essentially, the study by Horward (1995) demonstrates that enterprise growth cycles cannot be collapsed into a universal model; indeed Dorothy *et.al.* (1998) admit that their model may not fit all types of small businesses.

2.4 Type of Business and Access to Formal Credit

By implication, enterprises that have the sole proprietorship type of ownership are less inclined to seek out credit relative to enterprises under other ownership structures. Sole proprietorships are therefore less prone to risk taking (Omiti & Kimuyu, 2000)

2.5 Income

Omboi and Wangai(2011) found out that the level of income of a small-scale entrepreneur is an important component that determines demand for credit. Simple logistic regression analysis on predictor variable income to demand for credit shows, the odds that a small-scale business operator with zero income would demand for credit are 0.896 to 1.00. For each additional income, the odds that an entrepreneur with low income will borrow credit are increased by about 0%. The results are significant at 1% level of significance. This study finding implies that, holding other factors constant, there is always demand for additional finances for the household utilities but, at low levels of income, the entrepreneur has limited resources to save hence less demand for credit than at higher levels of income (this is a probable assumption because economic activities, needs and expenditure, increase with the individual's income). It may also be a true assumption that with higher income, the entrepreneur may be able to save more and acquire assets which can be used as collateral to borrow loans.

Demand for credit is shown to be more in households with higher income indicating that these entrepreneurs had better ability of repaying loans extended to them by formal commercial banks or any other formal financial institutions. Due to their ability to generate higher incomes, they had accumulated collaterals to secure loans. What this implies is that wealthier entrepreneurs were more likely to succeed in securing credit from formal financial institutions while the less wealthy individuals probably obtained from the informal sector (Omboi & Wangai, 2011).

3.0 Research Methodology

3.1 Research Design

While carrying out the study, the researcher utilized descriptive survey and literature review to structure the research. The study adapted a descriptive survey design. This design was used to determine the nature of an existing state of affairs within the population. The specific survey employed by the study was sample survey which studied a population through sampling method in order to answer the research questions. Both quantitative and qualitative approaches were utilized and this was appropriate due to its safeguard against bias and its ability to maximize reliability and concern for economic completion of the research study.

3.2 Population and sample

The target population was all small scale enterprise operating in Mt. Elgon district. Only SSEs that had existed for more than 2 years were considered totalling around 1200. The target population was stratified into homogenous categories as wholesalers, retailers, and restaurant and service delivery. Samples of 120 SSEs were randomly and proportionally drawn from the population strata. A structured questionnaire was used to collect data. An interview schedule was used to solicit for in depth information from key informants pertaining access to credit by SSEs.

The target population was stratified into homogeneous categories as wholesalers, retailers, restaurants and service delivery. A sample of 120 MSEs was drawn proportionately from the strata. Elements from each stratum were selected using random sampling technique to give each element an equal chance to constitute a sample of 120.

3.3 Data and methods

Data was collected by the researcher using a structured questionnaire and structured interview. In this study, the semi- structured questionnaire was used to collect data from all respondents and analysed using SPSS software. Data was summarized and presented using percentages, means and standard deviation chi-square and t- tests were used to establish relationships between categorical and continuous data respectively.

4.0 Study findings

4.1 Performance of small scale business in Mount Elgon Constituency

The performance of small scale enterprises in Mount Elgon Constituency was sought based on performance indicators measured subjectively on a likert scale (table 4.2). Table 4.1: Performance of small scale business

Statement	Strongly agree	Agree	Neutral	Disagree	Strongly disagree	Mean (SD)
Daily sales volume is increasing	8(6.7)	97(80.8)	15(12.5)	0(0)	0(0)	2.1(0.4)
Average monthly profit is increasing	8(6.7)	89(74.2)	18(15)	5(4.2)	0(0)	2.2(0.6)
Monthly business savings is increasing	6(5.0)	84(70)	23(19.2)	7(5.8)	0(0)	2.3(0.6)
Number of customers are increasing	23(19.2)	68(56.7)	29(24.2)	0(0)	0(0)	2.1(0.7)
Number of staff or employees are increasing	0(0)	39(32.5)	71(59.2)	9(7.5)	1(0.8)	2.8(0.6)

Majority agreed that daily sales volume was increasing 105(87.5%), average monthly profit was increasing 97(80.9%), monthly business savings was increasing 90(75%), number of customers were increasing 91(75.9% and only 39(32.5%) reported that number of staff or employees were increasing as in table 4.2. On average, they agreed that daily sales volume, average monthly profit, monthly business savings and that number of customers was increasing

4.2 Performance of the business and access to credit by SSE

Table 4.2: How the performance of the business affects access to credit by SSE

Factor	Accessed		t-value	P-value
	Yes	No		
Daily sales volume is increasing	2.0(0.4)	2.1(0.5)	1.023	0.313
Average monthly profit is increasing	2.1(0.6)	2.4(0.6)	2.748	0.009
Monthly business savings is increasing	2.2(0.6)	2.5(0.8)	2.247	0.031
Number of customers are increasing	2.0(0.7)	2.1(0.6)	0.850	0.397
Number of staff or employees are increasing	2.6(0.6)	3.3(0.5)	5.501	<0.001

The first objective of the study was to determine the effect of performance of business on access to credit by SSEs. Monthly profit, savings, number of customers and staff were performance indicators. There was a significant relationship between performance of the business in terms of increase in average monthly profit, monthly business savings, number of staff or employees and access to credit by SSE. For small scale enterprises to access loans, is imperative that they be in sound position in terms of performance. Information on performance is used to determine the ability of an enterprise to repay the borrowed funds. This implies that performance of an enterprise can be used to predict access to credit. Monthly profit and business saving are key performance indicators that credit providers consider in order to advance business loans. Demand for credit is shown to be more in households with higher income indicating that these entrepreneurs had better ability of repaying loans extended to them by formal commercial banks or any other formal financial institutions. Due to their ability to generate higher incomes, they had accumulated collaterals to secure loans. What this implies is that wealthier entrepreneurs were more likely to succeed in securing credit from formal financial institutions while the less wealthy individuals probably obtained from the informal sector (Omboi & Wangai, 2011). Therefore small scale enterprise owners/managers should concentrate on performance so as to be sure that they could access credit when need be.

4.3 Effect of characteristics of the business on access to credit by SSE

Table 4.3: How the characteristics of the business affects access to credit by SSE

Factor	Accessed		Chi-square	P-value
	Yes	No		
SSE ownership				
Sole	81(81)	19(19)	9.078	0.018
Partnership	11(57.9)	8(42.1)		
Other	0(0)	1(100)		
Age in years				
One	4(50)	4(50)		
Two	17(60.7)	11(39.3)	10.365	0.035
Three	39(83)	8(17)		
Four	11(84.6)	2(15.4)		
More than four	17(89.5)	2(10.5)		
Branches				
Yes	10(100)	0(0)	3.320	0.114
No	82(74.5)	28(25.5)		
Number of employees				
<5	72(72)	28(28)	7.304	0.007
≥5	20(100)	0(0)		

The second objective of the study was to determine the effect of business characteristics on credit access by SSE. The findings of the study revealed that age of the business, business ownership, having other branches and number of employees significantly affected access to credit by the SSE ($p<0.05$). By implication, enterprises that have the sole proprietorship type of ownership are less inclined to seek out credit relative to enterprises under other ownership structures. Sole proprietorships are therefore less prone to risk taking (Omiti & Kimuyu, 2000). A higher proportion of those with branches and more than 5 employees accessed credit. Also, the proportion of those accessing credit increased with increase in the age of the SSE. This implies that as enterprises grow and expand they need more financing. A growing enterprise has a good sign of sustaining loan repayment. This finding is not in agreement with Dorothy *et.al.* (1998) who agree that it is the younger growth firms that may be able to secure the more attractive financing forms. Unlike the case of their larger counterparts, financing for smaller enterprises is anything but standardized; funding sources for small enterprises may range from internal injections to debt financing.

5. Conclusion

Based on the findings of the study, it can be concluded that owner characteristics, business characteristics, group membership affects access to credit by SSEs in Mt.Elgon constituency.

One of The finding was that age and education of owner were significantly predictors of access to credit. Therefore, it can be concluded that mature and educated owners of SSE are more likely to access credit form MFIs. Also, it was found that the age of the business; business ownership and size were significant predictors of access to credit by SSEs. Therefore, it can be concluded that the older the business the more likely to access credit. Business partnership also enhances access to credit and the larger the business size the more likely it can access credit.

The finding of main objective was that performance of SSEs significantly affected access to credit. Therefore it can be concluded that SSEs that perform better are more likely to access credit from MFIs than those that perform poorly.

The fourth objective was that group membership was a significant prediction of access to credit. Further, it was found that group lending with individual liability was the most popular lending technique. Therefore it can be concluded that for SSEs to access credit, owners must form groups that act as collateral to access loans. It can also be concluded that borrower's prefer individual liability in their groups.

2. Recommendations

Based on the above conclusions, the research recommends the following to be adopted at various levels. Unemployment and educated youths should consider establishing SSEs and approach MFIs for funding to grow their businesses SSE owners/youths should be encouraged to establish partnerships. This will diversify risk and enable them to establish large enterprises that are attractive to MFI service providers.

Performance of SSEs should be a priority. Good performing SSEs are more likely to repay their loans and therefore attractive to MFIs. Owners /mangers should acquire skills adequate to drive the performance of their businesses. Finally, SSE owners should be encouraged to form groups which provide social capital that attracts MFI services easily.

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