

# Effect of Credit on Micro and small Enterprises Performance in Kitale Town

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## **Abstract**

The MSEs contribution to the growth of the national economy continue to assume increasing significance especially in job creation . These enterprises are created to fulfill the primary needs of man and are formed under conditions of risk and considerable uncertainty .This sector is encumbered by many problems chief among them being financing. A number of organizations have stepped in to finance their operations and solve this problem and promote their business performance. Its in light of this that this study was carried out with the objective of conducting a study to determine the effect of credit available to MSEs on business performance in Kitale town. More specifically this research sought to establish the effect of credit on kinds of assets acquired , market share served , stock levels held in the business and number of employees added in business..

On the effect of credit available to MSEs on business performance by considering value of assets acquired on accessing credit, it was found that credit available to MSEs does not necessarily lead to addition of assets. The effect of credit available to MSEs on expanding market share, it indicated that credit availability does not guarantee a bigger market share. The effect of credit available to MSEs on business performance by considering stock levels held it revealed that little money was allocated to purchasing of additional stock. On establishing the effect of credit available to MSEs by considering additional number of employees it was found that MSEs do not necessarily lead to good performance.

**Key words:** Perfomance, Effect, Micro enterprises, Small enterprises, Credit

## **Introduction**

A number of studies have concluded that the performance of MSEs is expected to improve with credit intervention ( Oketch, 1991,Sebstad and Walsh, 1999,Kibas ,1995 and Ondiege, 1996) but other studies (Sethna 1992 and Musinga 1994) found that there was lack of

substantial growth in MSEs even after receiving credit facilities from diverse sources. According to (Osman,1989), high rate of interest on loans is effectively a burden on the incomes of the poor. Given the low capital intensity of investment made through lending institutions and the resultant low profit margins ,high interest rates dampen the possibility of any significant savings on the part of the poor borrower who largely borrows to meet consumption related to household requirements .Therefore the fast economic growth anticipated after use of credit is not achieved instead a marginal economic growth is witnessed. This perhaps explains why there is continues increase in unemployment and poverty is on the increase despite efforts being made to improve the performance of MSEs which have been widely accepted a being engines of national economic development. A study conducted by ( Rahman ,1994) ,in Tangai district of Northern Bangladesh , found out that the timely repayments of loans taken from Grameen bank were not made from incomes gained from business operations but through further borrowing from private money lenders, therefore few of these MSEs ever develop into mega business concerns and a large number of them either remain small or simply fizzle out. It can be noted that credit to MSEs have been found to cause trauma and even self pity and unfulfilment perpetuating a vicious cycle of financial problems to majority of borrowers . This study therefore focused on determining the effect of credit available to MSEs on business performance.

The economic potential of the MSEs has been appreciated world wide and concerted efforts are being made to transform the sector economically. The MSEs are started by people unable to find jobs in the modern sector, retrenched and illiterate semi- illiterate people whose economic potential can greatly be exploited if they can be financially empowered and their talents nurtured.The MSEs have been recognized as engines for growth and development . In many countries there has been considerable effort to support them so as to create the necessary employment opportunities, incomes and productive capacity (Mwarania, 1993). The MSEs contribution to national development first gained recognition after the international labor organization employment mission of 1972 (ILO,1972).The mission's report gave various recommendations in relation to the promotion of the sector. They included increasing credit availability, establishing special institutions of education and training ,reorganizing of the informal sector in order to enhance provision of inputs ,technical aid and research so as to encourage production and rationalization of output (Ngu,2001). The importance of developing small scale African business men so that they can play the full role in the economic development of Kenya has in the recent years began to receive due recognition, the small scale indigenous businessmen are a big majority and are therefore potentially very important in the general development of the National economy (Kilonzi, 1992). Its important to note from the onset that when the MSEs are able to stand on there own feet after receiving the necessary support, they will immensely contribute towards national development and poverty eradication by providing employment opportunities to the marginalized poor who have great economic potential of operating profitable enterprises .

The Kenyan government through Sessional papers (No.1 of 1986, and No 2 of 1992 No 2of 2005) outlined policies and strategies for MSEs development that had been realized as channel for economic growth . The government fully committed itself to enterprise development

through economic, financial regulatory policies and the provision of adequate infrastructure .The papers have emphasized on the need for adequate access to credit ,management and technical training. Also the 1997-2001 development plan underscored the significance of MSEs in employment creation. It outlined improved ways of accessing credit and finance and on how to support women and youth in the informal sector Kenya. According to the economic survey of 2003, the Kenyan government's initiatives since President Kibaki came to power in the year 2002, has made concerted efforts to assist the MSEs .The MSEs feature prominently in the governments strategy for raising income and employment This can be witnessed in the creation of the youth and women funds to advance financial credit facilities to MSEs, these funds provide seed capital to women and youth seemed destined to achieve some modest success in creating a new crop of small entrepreneurs as well as jobs in their enterprises. This government is committed to reversing the past decades of economic decline, mismanagement ,contraction of per capita income and increase of the number of people living below the poverty line .It has prepared the economic recovery strategy for the wealth and employment creation 2003-2007, vision 2030 strategies among others to revive the private sector activity and investment and specifically MSEs development.

It can be well noted that the Kenyan government has embraced the spirit of promoting the MSEs through the establishment of many policies to enhance the sector through provision of credit and other services to improve on productivity. It is therefore evident that the contribution of this sector to the national economy and poverty alleviation among others is recognized and that is why the government and its several agencies endeavor to create an enabling environment for entrepreneurs. Despite the governments efforts to assist the informal sector through provision of funds and capacity building since 1963 to date ,we are still not receiving very positive results as poverty and unemployment is on the rise, suggesting that the programmes initiated by the government and other stake holders like MFIs,GAs,NGOs and others to uplift the sector may not be working to be able to lead to economic sustainability hence necessitating the need to conduct this research to determine the impact of credit facilities in improving business performance.

A survey conducted in Uasin Gishu district on the performance of the joint loan Boards credit scheme (Wakuloba, 2005) revealed fundamental findings on the effect of credits advanced to MSEs by government lending institutions:

**Table 1.1Performance of Joint loans boards scheme In Kenya (2000-2004).**

Financial year	Loan Disbursed Ksh	Amount Recovered Ksh
2000/01	23,684,000.00	17,438,003.83
2001/02	5,385,000.00	717,455.65
2003/04	18,585,000.00	15,431,083.18
2004/05	21,227,000.00	11,543,646.59
TOTAL	90,217,577.00	73,345,107.47

*Source: Joint loan Boards scheme M&E of joint loan Boards Report 2005*

Table 1.1 indicates that the credit facilities advanced MSEs are not regularly serviced when they fall due, leading to an increasing number of defaulters. The current researcher sought to determine the effect of credit available to MSEs on business performance.

**Table 1.2 : Rural enterprise fund outstanding balances (1995 -2000)**

Financial year	Cumulative repayment Ksh	Outstanding Loan Ksh
1995/96	1,309,020.20	4,482,072.00
1996/97	1,467,543.70	6,625,890.00
1997/98	1467,923.10	6,805,901.60
1998/99	1,566,296.30	7,400,312.10
1999/00	153,682.60	6,647,900.60
2000/01	256,284.60	8821,774.60

*Source: Compiled from Rural enterprise fund records Uasin Gishu District report 2005*

Table 1.2 loan repayment analysis from the rural enterprise records, its crystal clear that the outstanding loans balances advanced to MSEs keeps on growing on the subsequent years depicting a problem with the performance of these enterprises. The survey was more concerned with repayment of credit/loans in determining the performance of MSEs rather than looking at the profitability of these enterprises ,savings, assets ,market share, employment and stock levels

A baseline survey was conducted by the researcher in Kitale town Kenya (2008) to identify the MSEs operating in four market centers accessing credit from diverse sources to improve their business performances and keeping records of their operations The 4(four) market centers namely Soko mjinga market ,Nyayo market, Jua kali market and Municipal market are located within the same vicinity and attract customers from the same environment. The area of conducting business are similar. The survey revealed that 1,827 MSEs access credit from diverse sources including GAs. NGOs ,MFIs, MGRs among others to promote their businesses while 269 MSEs do not use credit. The survey reported that it was only 465 MSEs who keep records of their operations and they formed the basis of this study to determine the effect of credit available to MSEs on business performance.

The “informal” or “Jua kali” sector has often been a subject of study and speculation in terms of amount of employment it can generate and its impact on growth of the economy. Its imperative to get a brief definition of what micro, small, medium enterprises are: There are different definitions, all of which are arbitrary. This research however, adopts one on which a limited consensus has been reached, which employs as its yard stick the number of workers in a firm.1 – 5 ( or 10) - micro, 5 (or 10-25) (or 50) -small ,25 (or 50) – 100 ,medium and Over 100 is a large enterprise ( Kavanamur 1994).From the onset it can be noted that most MSEs start small and develop gradually until they become full-fledged self sustaining organizations. Therefore its important to comprehend their performance in order to appreciate their economic growth and development.

### **Hindrances to the growth and performance of MSEs**

Several studies have identified hindrances to the growth and performance of MSEs sector. (Aboagye,1986,Anderson,1982,Jeans, 1991,King, 1974,Leys ,1975,Marris and Somerset, 1971,Quijano,1974, Bienefield,1975,Tokman and Souza,1976). They lack space and infrastructure to locate and expand operations as most of them are located on poor sites .They face stiff competition amongst themselves due to formation of agglomerations according to particular trades and specialization's. They lack entrepreneurial culture as a bottleneck to the growth of the informal sector as there is little advanced planning . They lack technological ability which inhibit their growth due to limited finance and lack of appropriate raw materials and equipment They are also exploited by the formal sector due to the limited production capacity limiting their ability to accumulate the capital necessary for it to invest in technology and skills explaining why the micro enterprises do not grow into medium scale and large enterprises. They lack adequate funds for business startup and expansion making them to built up gradually and most of them barely last 5 years. The situation is further aggravated where the income received is both a household and production asset. They lack education and training limiting the full potential of both the individual and the enterprise. They have a limited access to the market as MSEs start businesses on a small scale in a market they know they can reach which is part of a much larger market where more powerful competitors are ready to exploit hence concentrate on other marginalized people .

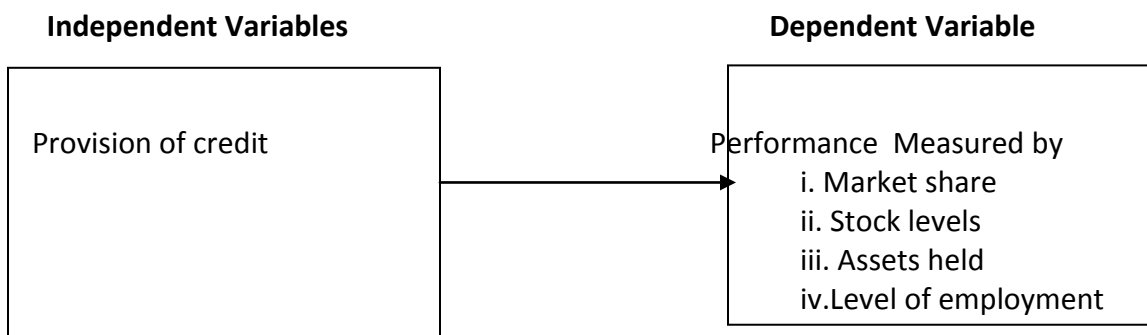
### **Measures of Performance of MSEs**

The measure of performance of MSEs are performance indicators which are commonly used to help an organization define and evaluate how successfully it is, typically in terms making progress towards its long term organizational objectives( Gibbson 1990).They are therefore quantifiable measurements agreed to beforehand ,that reflect the critical success factors of an organization. Measurement of actual performance must be done in the same terms in which standards have been laid down so that comparisons are easier and meaningful. MSEs performance can be measured in monetary terms like profits, costs, expenses, incomes or revenue, savings and value of assets held. It can also be measured quantitatively like units of production, units of sales / percentage of market share and quantity of stock held. In terms of time measurement, it includes man- hours or machine - hours. Performance of MSEs can also be measured in terms of capital employed typically expressed in financial terms as rate of return on investment or in terms of current ratio arrived by dividing current assets to current liabilities(Ivancevich,1980).It is important to note that the key performance indicators will differ depending on the organization but whatever measurements are selected they must reflect the organizational objectives, they must be key to its success and they must be quantifiable(measurable).

### **Conceptual framework**

MSEs increasingly seek credit facilities as away to enhance their income and self employed in a variety of sectors .There are many GAs,NGOs and MFIs which offer credit services to the MSEs This study focused on the effect of credit available to MSEs on business performance. The independent variable considered in this study was the provision of credit while the

dependent variable is performance and it was measured by employment provided, number and value of assets acquired due to use of credit, stock levels and market share acquired.



Source: Researcher (2010)

**Research Methodology.**

A research design is the specification of methods and procedures for acquiring the information needed to structure and solve problems. It mainly focuses on the study population, the sampling procedures, data collection methods and data analysis procedures to be used in order to establish the relationships between the dependent and independent variables. Another way of looking at research design is as a way of arranging the environment in which a research study takes place (Fims, 2003). This research used the descriptive design which provides information on groups and phenomena that already exist and no new groups is created (Fink, 2003). Descriptive research describes conditions, events and situations of the present as opposed to the historical research which describes the past (Good, 1963).

**Population of study**

This study was carried out in Kitale town Trans Nzoia West District. The town center has Four(4) major markets comprising of a high concentration of all types of MSEs in major sub sectors like commerce/trade, service and manufacturing. The researcher chose the four centers for easy of making reliable conclusions. These centres are Soko mjinga, Nyayo market, Municipal market and Jua kali markets. These markets have stalls of basically same size and structures and are within same vicinity. The proximity of the researcher to the area of research was considered. The number of MSEs who responded to all questionnaires were 120

**Sample size and sampling technique**

The researcher prepared a list of credit beneficiaries from the four markets. These are the MSEs who have been receiving credit from different sources and keep records of their business performances to enable make comparisons of their performances before and after accessing credit. A pre-prepared list of credit beneficiaries was not available since the MSEs do not receive credit from same sources. The researcher used four research assistants to compile the list from each market. The researcher's list is as follows; Soko mjinga one hundred and forty (140), Municipal market, one hundred and eighty, (180), Nyayo market, one hundred

(100) and Juakali, forty five (45). The total number of MSEs identified were four hundred and sixty five(465). Because the number is relatively large a sample of at least 30% of the target population from each market is selected (Kothari, 2002). The justification for using 30 % of target population giving a total of 140 MSEs to be used in the study has been captured in the limitations of the study outlined herein . Furthermore, based on past studies conducted on performance of MSEs , (Kibas,1995 ,Sebstad and Walsh,1991,) used between 35 to 40 MSEs in their studies while the current researcher's population is more by three times. Also, the researcher applied the incidence rate principle of the characteristic being investigated which is the access of credit , since its a common characteristic among the population of study, then the sample may be reduced without affecting in any way the equal sample representation. This study used cluster sampling to identify groups of MSEs to be used in the study from each of the four markets who have been receiving loans and keep records of their performances. Random sampling was used to ensure that each element in the population of study had an equal chance of being in the sample.

### **Data collection instruments**

Primary data collection utilized interview for those who were semi illiterate or too busy to exhaustively fill the questionnaires on their own ,while those who were able to read and write were requested to spare some time and fill the questionnaire, while secondary data was collected from relevant literature's .The questionnaires was open ended . According to (Mugenda and Mugenda,1999),its observed that the interview instrument yields high responses and personal and sensitive information can be extracted. According to( Kerlinger ,1973), its observed that people are willing to communicate orally than in writing and therefore provide data more readily. The questionnaire investigated pertinent issues on the effect of credit available to MSEs on business performance .

### **Data analysis**

The completed questionnaire was edited for consistency and completeness. Careful editing made coding easier. Coding involves assigning of numerical score or other character symbol to previously edited data. Data was analyzed using descriptive statistics with the help of SPSS. A database was created and data entered in a way that allows computation of basic characteristics such as tabulations of frequencies and percentages and measures of central tendency by way of mean ,median, and mode and measures of dispersion by way of range and standard deviation .The descriptive statistics measuring central tendency was calculated to show the relationship between variables. Different types of charts were used to effectively interpret frequency tables. Bar charts (histograms) Horizontal scale (baseline ) depicts the classes and the vertical scale represents the frequencies or percentages . Also Pie charts were used and the size of each pie slice corresponds to value associated with that choice.

### **Major Findings**

A total of 140 questionnaires were distributed by the researcher with the assistance of 4 research assistants to MSEs in four markets which formed the basis of this study. The MSEs were randomly picked from each market. Of the 140 questionnaires given out ,2 were

unanswered completely and 18 were vaguely or partially answered. Therefore 120 questionnaires were comprehensively answered making a response rate of 86%.

### **Gender of the operators of MSEs**

The frequency distribution of respondents according to their gender. The respondents' are assumed to be the owner managers of these enterprises and therefore bear all the risks of operating MSEs. These enterprises maintain full ownership of the business and are without undue influence from outsiders. The MSEs are started by people unable to find jobs in the modern sector, retrenched, illiterate/ semi-illiterate people to meet their physiological needs. It was noted that 43 percent of MSEs are operated by men while 57 percent are operated by women who are the most vulnerable group in the society. This implies that MSEs are dominated by women who are the marginalized members of the society and therefore gender of entrepreneurs influences the effect of credit they receive on their business performances.

### **The business sub sector MSE belongs.**

The percentage distribution of respondents according to their business sub sectors indicated that most of the MSEs are in commercial/trade sector represented by 61%, service sector 25% and manufacturing sector is 14%. The implication for these findings is that most entrepreneurs are lowly skilled hence tend to undertake business activities which require little or no expertise leading to high competition and thus affect their performance. The sub sector where majority of MSEs are concentrated tend to be saturated leading to market stagnation and business failure. The sub sector a MSE belongs will influence the effect of credit received on business performance.

### **Business management skills of MSEs**

The business management skills of entrepreneurs running their enterprises revealed that 43% of the MSEs have between 6-10 years in operating their businesses meaning that their expertise has been greatly improved due to their experience in their routine activities. This implies that most of the MSEs understand very well the enterprises they run and that's why they are able to withstand unfavorable economic turbulent than even large enterprises. Those entrepreneurs with less than 5 years of operating businesses even when supported financially the returns are minimal. Therefore the business management skills an entrepreneurs possess will influence the effect of credit on their performance.

### **Level of technical skills of MSEs**

On level of technical skills of the operating MSEs in the 4 markets in Kitale town. The largest percentage of respondents 37% have gone through secondary education, 30% tertiary, 30% primary and only 3% possess university education. Technical skills are the unique skills that one possesses either through education, talent or experience. These are the skills that drive the business. Technical skills differentiate one from the rest of the business operators. The primary and secondary level technical skills are general skills, from the responses received a total of 67% MSEs belong to this category implying that most of the business operators either copy or duplicate what others have innovated but proceeds from such activities are short lived as they



soon lead to stiff competition and market stagnation. Those with highly specialized skills from universities shy away from operating businesses. Therefore the level of technical skills an entrepreneur possesses will influence the effect of credit received.

### **Range of number of customers served per month**

The researcher notes that 36% of the respondents have testified that they serve between 50-1000 customers per month whereas their competitors serve a larger percentage that is, 64%. This implies that most MSEs believe that their competitors are superior to them. The market share served by MSEs will influence the effect of credit to MSEs on business performance. A large market share ensures adequate sales and hence good servicing of credit and vice versa.

### **Approximate monthly operating expenses**

The approximated monthly expenses incurred when operating MSEs. These are the costs that a MSE will have to incur in order to have smooth running of business, but they have to be within the income generated, otherwise high costs can reduce the profits and run down an organization. From the responses received 27,(22%) of MSEs spend well over Ksh 50,000 in terms of expenses depleting their profits further. Also 15,(13%) incur expenses below Ksh 5000. The kind of business operating expenses incurred will influence the effect of credit received by MSEs in business performance.

### **Amount of latest credit received**

On the amounts of credit received it can be noted that the amount of credit received should match with the level of growth of the business. From the responses received, majority of the entrepreneurs, that is 59% received a credit of less than Ksh 40000 from diverse sources to support their businesses. The credit given is too small to create self sustaining enterprises and that is why most of these businesses remain small. The amount of credit given will influence the effect of credit on the performance of business.

### **Cost of credit plus other charges**

On the cost incurred to access credit for use in businesses it was found that when the cost is high it compromises the performance of these enterprises by making credit expensive. On analyzing data received from respondents, 72 (60%) of MSEs incur costs plus charges of up to Ksh 10000 when accessing credit. The cost of credit influences the effect of credit in business performance.

### **Expenditure of credit received**

The expenditure of credit received by MSEs was spent differently. In cases where budgeting is organized, the amount of credit received will be allocated properly. Credit should be used wisely as it comes with a cost and the principal amount plus interest and other charges will have to be repaid. From the responses received 59(49%) of credit received is used to purchase assets and add stock to the business and also a good sum of credit that is 34 (29%) is spent on domestic and other non business related activities affecting the performance of these

enterprises. Therefore how an entrepreneur spends credit will influence the effect of credit received in business performance.

### **Number of employees before and after use of credit**

The number of employees before and after use of credit in a business. The number of employees in an organization and their respective qualifications is a measure of performance of an organization. Employees are valuable resources in any organization. As a business grows and expands, it is important for the entrepreneurs to also recruit even more specialized personnel to reflect the new status of the business. From the responses received from entrepreneurs, it can be noted that even after receiving credit the number of MSEs without an employee increased by 1%, that is, rose from 27% to 28%. Even those MSEs which added employees after use of credit were in the range of 1% to 2%. Some other businesses dismissed their employees implying that employees in an enterprise do not necessarily lead to good performance of a MSE, but can also increase the operating expenses and reduce the profitability of an organization. Therefore the effect of credit received by MSEs varies from one organization to another and can either increase or decrease the number of human resources in an enterprise.

### **Range of monthly stock held on accessing credit**

The responses on monthly stock held before and after use of credit in a business are the inventories used in running a business. The level of stock held is a measure of performance of business. The stocks held valued under Ksh 60000 were 63(51%) and 58(48%) after use of credit.

### **Approximate value of assets acquired on accessing credit**

The responses on the approximate value of assets acquired on accessing credit measure business performance. This is because they facilitate business transactions. From the responses received from MSEs before using credit in business, 76(65%) of the MSEs acquired assets worth under Ksh 20000 whereas after using credit 83(70%) acquired assets of the same value an increment of 5%. The MSEs with assets valued over Ksh 80000 were 10(7%), whereas after use of credit those with the same value of assets were 4(4%) a decline of 3%.

### **Discussions**

Most of the MSEs acquired at least an asset upon receiving credit. The value of assets acquired vary with the loan accessed, but in some cases the value of asset acquired was of more value than the loan accessed, meaning that the extra money used to purchase the asset was out of savings. Therefore credit available to MSEs does not necessarily lead to addition of assets.

The study revealed that most MSEs do not put more emphasis to understand the market share they serve. Despite receiving credit, their market share still remains low. This is reflected when the largest number of MSEs agree that their competitors are superior to them. This implies that they do little or no promotion and advertising of their products. This shows that credit availability does not guarantee a bigger market share.

The stock levels held by most MSEs are not bigger enough to ensure that every product as required by each customer is available. In fact, in some cases after accessing credit where we expect an increase in stock level, we realize the opposite. This implies that little money was allocated to purchasing of stock and thus availability of credit does not guarantee more stock if allocation for the same is not done.

The number of employees increased marginally even after MSEs accessed credit and also there are those MSEs who did not have plans of hiring workers. The implication for this findings is that, most MSEs did not see the value of having employees in an enterprise because employees do not necessarily lead to good performance, but may also compromise the performance of an organization.

### **Recommendations**

The assets acquired in a business are very crucial as in most cases act as collateral when one needs to access credit from a bank or other lending institutions. They are also a means of increasing productivity in an organization. Therefore all efforts should be made by all MSEs to acquire those assets that promote their efficiency and effectiveness thereby improving business performance.

The MSEs should use all means available to comprehend their market share in order to develop relevant promotional programmes. It is imperative entrepreneurs know the consumers of the products and services they have, so as to appropriately satisfy customers needs. Also they should know the competitors strengths and weaknesses then plan on how to outdo them.

It is important to ensure that every product as required by each customer is available. A good stock of products to be sold will create confidence with your customers and will also ensure continued flow of funds into the business. All MSEs to make effort of availing all the products related to the nature of business undertaken.

Employees in any organization are resources who should be well taken care of by every employer. These are the most superior resources of all resources known. This means that the right number and qualified human resources should be acquired in any organization. In organizations

where we have specialized human resource, the results are satisfying and every kind of efficiency and effectiveness is witnessed.

All the entrepreneurs to embrace and develop their personal characteristics where possible to improve their efficiency. They include the individuals business management skills, level of technical training, gender of the entrepreneur and the expenditure of credit so as to experience the effect of credit available to MSEs in business performance.

The MSEs characteristics should also be well take care of when accessing credit from lending institutions. These includes amount of credit given, cost of accessing credit, type of business preferred, the size of business operating and the expenses of operating the business.

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