International Journal of Science and Research (IJSR)
ISSN (Online): 2319-7064
Impact Factor (2012): 3.358

The Effect of MFI Credit on Revenue of SMEs, a Survey of Small Medium Enterprises in Nakuru Town

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Abstract: ***SMEs sector is the source of income for 8 million people who represent the majority of working Kenyans. Despite their large contribution in development and economic performance they are mainly inhibited by access of finance. Large commercial institutions have failed to serve the SMEs in both urban and rural communities. They perceive them as lacking the ability to provide the quality services and are unable to satisfy more critical projects. Given the importance of small businesses to the Kenyan economy and the exposure to risks owing to their size, there was need to conduct an empirical enquiry to investigate the effect of MFI on performance of SMEs in Nakuru District face. The study used both quantitative and qualitative data. Primary data was collected through observation and structured questionnaires. The population was 700 SMEs in Nakuru District. Out of this a sample 248 SMEs was selected on basis of Krejcie method of determining sample size. These were categorised into two the SMEs that receive credit from MFI and those that do not. Frequency tables and graphs were used to display the results. The study recommends that SMEs should exploit the opportunity of obtaining MFI credit so that it can boost their revenue growth.***

Keywords: SSME, Financial stability, Nakuru District, MFI

1. Introduction

Since its beginning in Bangladesh, Micro-Finance (MFI) has expanded to scores of other developing countries and even to some developed countries. According to the Consultative Group to Assist the Poor (CGAP)'s microfinance gateway there were in 2006 more than 7,000 micro credit institutions, serving about 500 million people in more than 50 countries, including some developed countries. Clearly, the role of MFI is an important issue especially in financing the SMEs who find it costly to access credit from Commercial Banks.

The Kenya government in the Vision 2030 plan has identified the SMEs as an important priority. In order to achieve performance, adequate sources of finance are needed for SMEs. Therefore there is need to engage MFI to finance the SMEs since large financial institutions shun SMEs because they perceive small business as lacking the ability to provide the quality services and are unable to satisfy more than one critical project simultaneously. Studies conducted suggest that finance is the most important constraint for the SMEs sector (Amin et al, 2003).

Empirical Studies have shown that SMEs can contribute up to 45% of employment and up to 33% of GDP in developing economies. SMEs Sector is the source of income for over 8 million people, who represent the majority of working Kenyans (World Bank Report, 2011) and Micro and Small Enterprises (SMEs) sector can contribute to the achievement of a wide range of development objectives, including: the attainment of income distribution and poverty reduction (DFID 2000); creation of employment (Daniels, 1993); savings mobilization (Beck et al, 2005); and production of goods and services that meet the basic needs of the poor (Cook, 2001). While estimates vary greatly depending on definitions, recent work by the World Bank suggests that almost 30 per cent of employment in developing countries and Kenya alike is generated by the (informal) Micro and Small Enterprises, while an additional 18 per cent is provided by (formal) Small and Medium Enterprises. Together these two groups contribute 63 per cent of the GDP (Ayyagari, 2003). Despite SME's large contribution in countries development and economic performance, their performance and development in developing countries were mainly inhibited by access of finance, poor managerial skills, and lack of training opportunities and high cost of inputs (Cook & Nixson, 2000). Further studies conducted suggest that finance is the most important constraint for the SMEs sector (Green, 2003). However, this sector faces many challenges, such as financial exclusion and a lack of access to credit. According to the Kenya Ministry of Finance 2011, the Government was taking the necessary steps to transform the SMEs sector to be one of the key drivers for achieving a broad based economic performance, employment creation and poverty eradication. Access to finance remains a key constraint to SME development in Kenya.

Past statistics indicate that three out five SME fail within first few months of operations Kenya Bureau of Statistics, 2007. According to (Syekei, 2005) one of the most significant challenges is negatives perception towards SMEs. Potential large commercial financiers perceive small business as lacking the ability to provide the quality services and are unable to satisfy more than critical projects simultaneously. Often large companies are selected and given business for their clout in the industry and name recognition alone. Because of their small size, a simple management mistake is likely to lead to sure death of SMEs hence no opportunity to learn from past mistakes.

The 1999 National Baseline survey conducted by central bureau of statistics, ICEG and K-Rep holdings provides the most recent comprehensive picture of SMEs in Kenya. (Mead, 1998) observes that health of economy of as a whole has strong relationship with the health and nature of SME sector. When state of the micro economy is less favourable, by contrast, the opportunities for profitable employment expansion in SMEs are limited. This is true for those SMEs that have linkages to larger enterprise and the economy at large. Given this scenario, an understanding of dynamics of SMEs is necessary not only for the development of support programmes for SMEs, but also for the performance of the economyas whole. Given the importance of small businesses to the Kenyan economy and the exposure to risks owing to their size, there was need to conduct an empirical enquiry to investigate the effect of MFI credit on revenue of SMEs in Nakuru District. The study targeted SMEs in Nakuru district.

The SMEs have very limited access to financial services from formal financial institutions to meet their working and investment needs (Kessy, 2010). However, the generation of self-employment in the SMEs requires investment in working capital, at low levels of income, the accumulation of such capital may be difficult. Under such circumstances, loans can help the poor to accumulate capital and investment in employment generating activities (Hossain, 1988). According to (Grade, 1984), loans enable the individual's member or enterprises to enjoy the benefit of economies of scale and new technology.

Availability of credit to small business and low income SMEs could greatly enhance their economic strength and eventually break the vicious circle of low income – low saving – low investment – low income (Yunus, 1984).

2. Literature Review

(Simeyo, 2011) did a study on effect of provision of micro finance on the performance of micro enterprises: A study of youth micro enterprises under Kenya Rural Enterprise Program (K-REP), Kisii County, Kenya. Small Medium Enterprises (SMEs) sector contributes 20% to the GDP of the Kenyan economy. The vision of MFI is to promote the growth of SMEs which is indicated in the increase in revenue. In pursuit of this vision, the rapid growth of MFIs has made SMEs access to credit more than doubled from 7.5% in 2006 to 17.9% in 2009. Despite this increase, a recent study has shown that over 50% of SMEs continue to have a deteriorating performance with 3 in every 5 SMEs failing within months of establishment.

It's a subjective measure how well an SME can use assets from its primary mode of business and generate revenues. This term is also used as a general measure of a SME's overall financial health over a given period of time, and can be used to compare similar firms across the same industry or to compare industries or sectors in aggregation (Russel, 2009). There are many different ways to measure financial performance, but all measures should be taken in aggregation. Line items such as revenue from operations, operating income or cash flow from operations can be used, as well as total unit sales. Furthermore, the analyst or investor may wish to look deeper into financial statements and seek out margin growth rates or any declining debt. Ultimately the universal measure of business performance is money and the ultimate forms of this measurement are the final accounts of SMEs if at all they are there. Money has the advantage that it can be used to measure the effectiveness and efficiency not only of different business functions such as marketing, engineering, production. According to (Richard, 2009), organizational performance encompasses three specific areas of firm outcomes financial performance that is profits, return on assets, return on investment, etc.; product market performance sales, market share, etc. In a survey on the quality, uses and perceived importance of various financial and non-financial measures, (Lingle, 2006) report wider disparities between the perceived quality and importance of non-financial measures as compared to financial measures. Perceived inadequacies in a traditional performance measurement system that focuses on financial measures have led many organizations to switch to and put greater emphasis on forward-looking non-financial measures such as customer satisfaction, employee learning and innovation (Ittner, 2008).

Most organizations view their performance in terms of effectiveness in achieving their mission, purpose or goals (Guralnik, 2004). The main goal of organisation is to increase the revenue. Most SMEs tend to link the larger notion of organizational performance to the results of their particular programs to improve the lives of a target group. At the same time, majority of organizations also see their performance in terms of their efficiency in deploying resources. This relates to the optimal use of resources to obtain the results desired. Finally, in order for an organization to remain viable over time, it must be both financially viable and relevant to its stakeholders and their changing needs. In the organisation framework, these aspects of performance are the key dimensions to organizational performance. Despite the growing interest in incorporating nonfinancial measures in an organization's performance measurement system, it is important to note that performance measurement and performance management are not the same. Each segment in a large organization may develop highly specific performance measurement information for its own operations and this will allow that segment to operate effectively. However, while each manager strives to optimize the performance of his division, the overall performance of the organization may be sub-optimized (Missroon, 2000). Only a performance management system engenders strategic evolution and ensures goal congruence. As the balanced scorecard provides a comprehensive, top-down view of organizational performance with a strong focus on vision and strategy, performance management can be greatly facilitated through its use (Missroon, 2000).

3. Objective of the Study

To investigate the effect of MFI credit on revenue of SMEs, a survey of Small Medium Enterprises in Nakuru District.

4. Methodology

The research employed two research methods these are quantitative and qualitative. According to (Saunders, 2007), quantitative method data is collected through a systematic empirical study and the results can be quantified with the help of statistics. This method was used to compare and study performance determinant; comparing revenue analysing and testing it empirically to prove if there are relationships with MFI credit.

A qualitative approach was more appropriate to fulfil the purpose of this research, since this project was researching the effect of MFI credit on the revenue of SMEs, the fact that observations, beliefs, ideas and point of views were difficult to measure in a quantitative way. By studying the firms' internal and external attributes with the qualitative approach it was possible to understand the opinions and beliefs that are affecting firm performance. On the other hand the quantitative method was used to measure how the SMEs revenue grows. With the quantitative method it was possible to compare different numerical performance measures. Data was collected from each SME by use of questionnaire regarding their turnover and sent to the SMEs through hand delivery.

According to (Burns, 2001), descriptive research is designed to provide a picture of a situation as it naturally happens. It may justify current practice and make judgement and also to develop theories. Main characteristics of this method are that researcher has no control of variables he can only report what has happened and what is happening. In this research there was no control of variables. It made use of cross-sectional survey and fact finding enquiries. The major purpose of this was describing state of affairs as it present.

This was the set of SMEs in Nakuru District to which findings are to be generalized which is 700 SMEs. It included those that receive MFI loan and those that do not. This population was given priority due to the need of getting empirical evidence from this area. The target population was SMEs in Nakuru District which benefit from MFIs and those that do not whose records are available at the Nakuru Municipal Business Licensing office. This target population was justified on the fact that they are the focus of this study.

A non probability sampling was performed; a sampling frame was constructed in the study area that is Nakuru Business District. The list of SMEs' in the study areas was generated from the selected microfinance institutions in this case Faulu Kenya. The list of control group was selected purposively. The SMEs to be included in the control group were those living in close proximity to the SMEs which access and use micro financing services.

Data collection may be done on representative sample of entire population. This study covered a total of 248 SMEs from the population which was obtained from Krejice and Morgan table based on a population 700. The coverage included 124 SMEs who have access and use micro financing services and 124 SMEs who do not use micro financing services (Control Group). SMEs which do not use micro financing services represented SMEs living in close proximity to those SMEs which have access and use micro financing services, but which did not at the time of the interview include persons with access and or using micro financing services.

(Kothari, 2004) points out that validity measures the accuracy of instruments in obtaining the anticipated data that can meet the objectives of the study and according to (Gay, 1992), it is established by expert's judgement. The researcher consulted the opinion of other experts (Lecturers in Jomo Kenyatta University of Agriculture and Technology, Nakuru CBD Campus) in assessing or validating the content of research instruments. The researcher reviewed the instruments accordingly based on their recommendations.

Pilot testing was done to identify items in the research instruments that might be ambiguous in eliciting the relevant information. It was modified in tuning up questionnaires in readiness for actual data collection. (Mugenda & Mugenda, 2007), declared that validity enhances reliability of an instrument. Hence a valid instrument is reliable but a reliable instrument may not be valid.

5. Data Analysis and Interpretation

5.1 Revenue Growth

The research sought to find the distribution of revenue from the 2008 to 2012. This was to be analysed in to two categories. That is the SMEs that receive credit from MFI and those that do not. This is to provide comparative figures whose trends will be viewed in a line graph. They were obtained by computing the mean of turnover/sales, other income and total revenue.

5.2 Revenue Trend of SMEs that Receive Credit from MFI and those that do not

The research sought to find the trend of revenue of SMEs that receive credit over a period of five years starting from year 2008 to 2012. To arrive at total revenue turnover was added to other income. The mean value of respondent's revenue was obtained and the tabulated. The tabulated results were used to draw a simple graph which was to show the revenue trend between the year 2008 and 2012. This output was in pair that is for SMEs that receive credit and those that does not receive MFI credit.

Table 4.14: Revenue Trend of SMEs that Receive Credit from MFI and those do not

	2008	**2009**	**2010**	**2011**	**2012**
Revenue of SMEs that Revenue from MFI.					
Turnover/Sales sh(million)	2.0	1.8	2.1	2.4	2.6
Other income sh(million)	0.2	0.6	0.6	0.6	0.7
Total Revenue sh(million)	2.2	2.4	2.7	3.0	3.3
Revenue of SMEs that do not receive revenue from MFI.	**2008**	**2009**	**2010**	**2011**	**2012**
Turnover/Sales sh(million)	2.42	2.15	2.30	2.21	2.61
Other income sh(million)	0.29	0.61	0.42	0.50	0.40
Total Revenue sh(million)	2.69	2.71	2.72	2.71	2.71

As described in the table below the trend is an upward trend with 2008 having revenue of sh2.2million. There is a constant growth for four year that is from 2009 to 2012. Revenue achieves a high value of sh3.3million. Values in Table 4.12 are shown in the curve in figure 4.1.

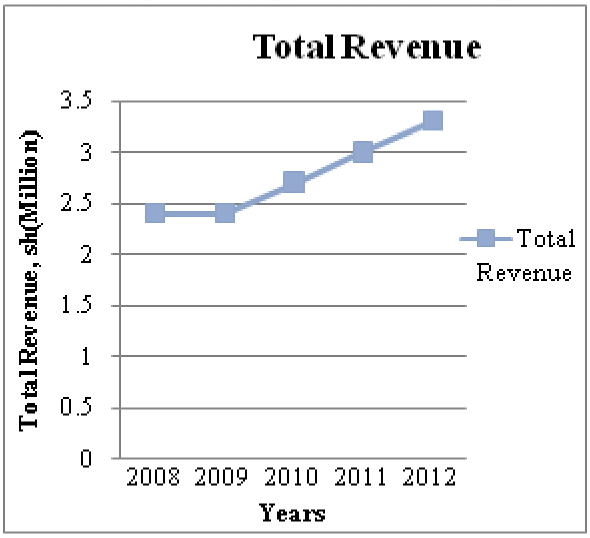

Figure 4.1: Revenue Trend of SMEs that Receive MFI Credit

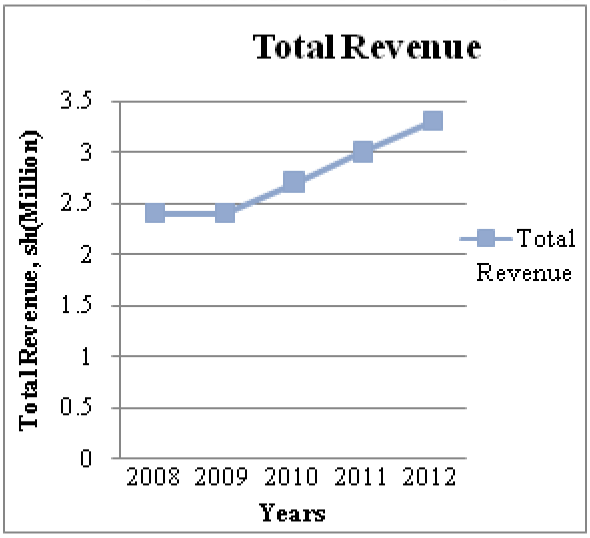

Figure 4.2: Revenue Trend of SMEs that do not Receive MFI Credit

The research sought to find the Revenue trend of SMEs that do not receive MFI credit. This was obtained through calculation of mean of from year 2008 to 2012. The values were to be tabulated and trend viewed in a graph. The rose from sh2.69million in 2008, to sh 2.71million to sh2.72 and went down to sh 2.71 million.

From the table 4.14 and in figure 4.2 the revenue was highest in 2010 at sh2.72 million and the slightly dropped in 2011 and 2012 to sh2.71million. This is trend that is not predictable. In the year 2011 and 2012 it remained high at sh2.71million as compared to the year 2008.

6. Discussion

The revenue, as the study reveals, of SMEs that have been receiving credit loan from MFI was on upwards trend. This was not the case for SMEs that do not receive MFI credit whose curve is raising but not in greater gradient as that of SMEs that receive credit. The upward trend is due to favourable interest rate since it has been disclosed that MFI interest is favourable. (Chowdhury, 2002) emphasises that favourable credit terms such as adequate loan amounts, affordable interest rates and flexible repayment schedules help SMEs keep enough finances to run their working capital activities, it helps them improve their performance because they will always have an opportunity cost of reinvesting their proceeds in order to generate more revenues which increases on their return on capital employed. In return, their (SME) net profit margin will raise something that lifts the capital size APEC (2003). In correlation test between MFI credit and SMEs revenue, this study found out that there is a strong positive correlation. The two variables move together in the same direction. Therefore the good relationship between MFI and SMEs is very important for the growth of SMEs.(Kumar & Jeyanth, 2007)that a good relationship between SMEs and MFIs helps them to easily access finances. They argue further that MFIs serve marginalised groups through education on business management.

7. Conclusion

The study concludes that there is a positive association between MFI credit and SMEs revenue. This is because when the MFI credit increases the revenue also increases. SMEs that had credit balance with MFIs had growth in terms of revenue. It is a positive indication that MFI credit boosts the performance of SMEs. Microfinance enables SMEs to become economic agents of change by increasing their income and productivity. On the contrary, the SMEs that did not receive MFI credit did not record growth in revenue. As past studies have shown, three out of five SMEs are forced out of business because of operation problems, it can be concluded that, this are SMEs that have no access to credit. If these SMEs had accessed low interest credit from MFIs then the number of SMEs that are forced out of business would reduce.

8. Recommendation

From the study there is some evidence that microfinance enables SMEs to be better placed to deal with shocks of the operating economic conditions hence financial sustainability. Microsavings may be a better model of increasing financial sustainability through accumulated revenue among SMEs. Small businesses are struggling to survive due to lack of funds or in ability to access credit. A great opportunity exists where these businesses can be financed and helped to grow. MFIs should come with programme that exploit this opportunity and help finance these small businesses.

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