Influence of Microfinance Services on Financial Performance of Micro, Small and Medium Enterprises in Kirinyaga County

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Abstract: This study sought to ascertain the influence of microfinance services on financial performance of MSMEs in Kirinyaga County. Specifically, the study sought to determine how microcredit services, micro-saving services and business consultancy services offered by Microfinance institutions influenced financial performance of MSMEs within the County as operationalized by growth in their sales turnover. The study was anchored on the theories of Information asymmetry and Financial intermediation**.** The study's target population comprised the MSMEs operating within Kirinyaga County and adopted the descriptive research design. The studied MSMEs were purposively selected from the townships of Sagana, Kerugoya, Kutus, Kagio and Kagumo. Primary data was collected using structured questionnaires and analysis of the collected data was performed using descriptive and inferential statistical techniques. The results were presented using tables and charts. The study found that all the services offered by microfinance institutions had a positive and significant influence on financial performance of MSMEs. Effectively, the study recommended that the owner-managers of the MSMEs should have more strategic engagement with the Microfinance institutions in tapping the services extended by them. Further, sustained efforts should be made by policy formulators to promote and strengthen microfinancing in pursuit of the Vision 2030.

Keywords: Microfinance Services, Financial Performance, Micro, Small and Medium Enterprises, Micro-credit, Micro-savings, Business Consultancy.

INTRODUCTION

Although there is no universal definition of Micro, Small and medium enterprises (MSMEs), KIPPRA (2016) opined that the number of employees, sales turnover and capital base are the key attributes that should be considered when defining them. In

Kenya, MSMEs comprise the enterprises with a staff capacity of 1-99 employees (GoK, 2019). Whereas Micro enterprises have less than 10 employees, small enterprises have 10-49 employees while medium sized enterprises have 50-99 employees. With regards to annual turnover, MSMEs are business enterprises whose total sales does not exceed Kshs. 50 million (KRA, 2021). Although these enterprises often operate informally, they are predominant in different sectors such as Agriculture, animal husbandry, Manufacturing, Trading, Transportation, Technology and innovation etc.

MSMEs play a pivotal role in Kenya's economy. According to Tagoe (2005), they contribute to over 90 per cent of total labor force and play a key role in poverty reduction and economic development. They are also a source of innovation, competitiveness, goods and services, and entrepreneurial skills. According to the Economic Survey (2023), there are over 17.4 million MSMEs in Kenya employing approximately 14.9 million Kenyans in various sectors of the economy. In addition, the MSMEs cover a wide range of establishments in almost all sectors of the economy. Moreover, the important role of MSMEs in promoting GDP growth and employment is underlined in Kenya's Vision 2030, the country's long-term development blueprint.

Despite the critical role they play in the economy, MSMEs are frequently confronted with market imperfections. Particularly, they face difficulties in accessing adequate, affordable and timely credit and most of them are unable to integrate into large-scale business relationships due to lack of international standards and quality controls. According to Hossain (2000), the difficulties encountered by SMEs when raising capital are attributed to the pre-occupation by financial institutions with collateral - based lending.

This has made the Government to introduce policies and initiatives meant to address the challenges faced in accessing finance and propagate sustainability of these enterprises with varying degrees of success.

In 2013, the Government under the Access to Government Procurement Opportunities (AGPO) programme set aside 30 per cent of all Government procurement for youth, women and persons with disabilities. The aim of the programme was to facilitate the youth, women and persons with disability-owned enterprises to participate in government procurement and therefore increase their market access along the production value chain (Cooper, 2016). Public funds advanced to the sector to address the access to credit challenge have included the Youth Enterprise Development Fund, Small and Medium Enterprise (SME) Fund, Uwezo Fund and Women Enterprise Fund. These funds are mainly designed to cater for the unique needs of the respective categories, who would not access credit from the formal system because of stringent requirements that they could not fully meet, for instance, lack of collateral to support their loan applications (FSD, 2020).

In an effort to bridge this yawning financing gap, the microfinancing sector has emerged in Kenya. Microfinance is the provision of financial services to low-income clients or solidarity lending groups including consumers and the self-employed, who traditionally lack access to banking and related services, (Armendariz & Morduch, 2010).

1.1. Problem Statement

The importance of the MSMEs subsector in spurring economic growth cannot be gainsaid. This comes in not only creating employment opportunities to the population but also in enhancing innovation as well as increasing production of goods and services. However, numerous studies have demonstrated that financing is a key challenge that persistently threaten growth and long-term sustainability of MSMEs. This challenge stems from the fact that the mainstream financing institutions perceive MSMEs as perilous borrowers because they operate in the informal sector. They therefore subject them to stringent lending requirements such as high collateral, loan guarantees as well as lengthy paperwork all of which starves the entities of the much needed capital. In an effort to mitigate against this problem, the Kenya government has under the Vision 2030 flagship programme rolled out the Uwezo fund, Women Enterprise fund and the Youth fund to enable women, youth and persons with disabilities access financing to promote businesses and enterprises at the constituency level. Further, the GoK has taken great strides in promoting the microfinancing sector which not only offers alternative and flexible mechanisms for financing the MSMEs but also provide additional services such as savings opportunities as well as business consultancy and training.

Kirinyaga County is predominantly agricultural, given the favorable weather conditions characterized by well distributed rains throughout the year. Majority of MSMEs in the County are agro-based although ancillary entities have emerged along the value chain. The County is also a large base of microfinancing institutions which have emerged to support the MSMEs subsector. Despite this phenomenon, there exist no study aimed at assessing how the proliferation of microfinancing institutions has influenced financial performance of the MSMEs within the County. This study sought to fill this gap.

1.2. Purpose and Objectives

This study aimed at determining the influence of microfinance services to financial performance of MSMEs in Kirinyaga County. The study was guided by the specific objectives listed below:

1.   To establish the influence of micro-credit services on financial performance of MSMEs in Kirinyaga County

2. To determine the influence of micro-savings services on financial performance of MSMEs in Kirinyaga County

3. To evaluate the influence of business consultancy services on financial performance of MSMEs in Kirinyaga County

1.3. Scope and Justification

The study was carried out within Kirinyaga County and targeted the 13,145 MSMEs registered with the County government and licensed to operate in different sectors. Specifically, the study collected data from MSMEs operating in the major townships of Kerugoya, Kutus, Sagana, Kagumo and Kagio. The study was necessitated by the need to evaluate how the services offered by the microfinance institutions influenced financial performance of the MSMEs in the County. Specifically, the findings from the study would enable the proprietors of the MSMEs to leverage on variety of services provided by the microfinance institutions in growing their entities. Further, the study findings will assist the County government of Kirinyaga in formulating policies aimed at deepening access to financial and non-financial services for the MSMEs subsector through MFIs.

2. LITERATURE REVIEW

This section provides a review of both the theoretical and empirical literature relevant to the study. It also provides the conceptual framework showing how the variables of the study are interrelated.

2.1. Theoretical Literature

The study was anchored on the Information Asymmetry Theory as propounded by Akerlof in his 1970 paper entitled "The Market for Lemons". By using the secondhand car market, the author argued that the seller who ordinarily has superior market information may take advantage of the ignorant buyers to overprice goods of less than average market quality. Equally, the buyers may be demotivated from buying more car units at the quoted price for fear of being scammed by the sellers concerning the quality of the available cars. In the long run, the author argued that this could greatly impact the market and lead to market failure. In their 2001 article, Stiglitz, Akerlof, and Spence further developed this theory by demonstrating how the financial sector in developing countries could be skewed when financial service providers, armed with superior professional knowledge, experience and networks exploited retail market participants who were not nearly as informed or connected.

Within the financial markets, pundits have argued that there exists information asymmetry between the commercial banks and MSMEs giving rise to adverse selection.

It is this adverse selection process that makes commercial banks desist to provide loans to MSMEs because they perceive them as risky borrowers. This is however inspite of the fact that there exists MSMEs that are significantly financially sound but they are discriminated upon because of information imbalance. Researchers have postulated that it is this information asymmetry that has engendered microfinance in within the MSMEs subsector in many developing countries in an effort to bridge the existing financing gap.

The study was also based on the financial intermediation theory which was developed in the 1960's as part of the preliminary work by Gurley and Shaw (1960). The theory sought to provide an explanation for existence of financial intermediaries who are actually providers of capital to the needy sectors. According to this theory, financial intermediaries; who are in essence financial institutions specialize in the function of buying and selling financial assets in form of money. They buy these financial assets from savers who have excess and resell the same to borrowers who have the need for it. In so doing, they make profits by buying low and selling high. The theory further provide that the price involved in financial intermediation transaction is the interest rates which is the cost of capital. According to this theory, the cost of capital is influenced by factors, key among which is the information balance existing between financial intermediaries, the savers and borrowers. Where information asymmetry is low, then the price charged is low but where it is high, the cost would be high. The theory justifies existence of financial intermediaries as key traders who facilitate the process of moving financial resources from areas of abundance to areas of need. Through financial intermediation process, business firms are able to invest in financial assets such as savings accounts and debt securities as well as borrow capital to extend their trading further. This theory is relevant to this study in that MSMEs, as business entities that require financial resources are usually crowded out of financial intermediation process because the lenders perceive them as high-risk borrowers. Where they manage to obtain financing, it comes at very high cost because lenders want to cushion themselves from the inherent risk of default that is fomented by information asymmetry that exist between MSMEs and lenders.

2.2. Empirical Literature

Nilsson (2010) conducted a study to investigate the impact of micro finance institutions (MFIs) on the development of small and medium size businesses (SMEs) in Cameroon. The study adopted a case study approach that involved CAMCCUL – (Cameroon Cooperative Credit Union League). The study concluded that microfinance is an important asset to developing countries since it is able to cater for financing needs of the very poor in the society.

Olu (2009) conducted a study on the impact of microfinance on entrepreneurial development of small scale enterprises that are craving for growth and development

in a stiffened economy of Nigeria. The study used a questionnaire as an instrument of primary data collection. Table and simple percentages were used in data presentation. The study revealed that microfinance institutions are evident tools for entrepreneurship development due to the various services they offer and the role they play towards the development of the economy.

Memba et. al, (2012) conducted a study to establish the impact of venture capital on growth of SMEs in Kenya. The study that analyzed 200 SMEs financed through Venture capital obtained from microfinance institutions and used primary data collected through questionnaires established that microfinance venture capital made significant growth in SMEs. The study recommended that other SMEs should follow suit if the country has to achieve its vision 2030.

Cooper (2012) conducted a study on the impact of micro-finance services on the growth of SMEs in Kenya. The study targeted 50 SMEs in Nairobi and used primary data collected through structured questionnaires. The study established that loans obtained from microfinance institutions had a positive and significant effect on the growth in sales revenues for the studied SMEs. The study attributed that finding to the fact that the loans were extended to SMEs at flexible terms and lower interest rates than those obtained from the commercial banks.

Vogelgesangu (2001) analyzed the impact of microfinance loans on productivity and growth of client s enterprises. The researcher used client database of Caja Los Andes, one leading micro finance in Bolivia. The results highlighted that the clients put the MFI loans to good use and clients with a higher number and a higher average size of MFI loans were found to have higher growth rates than other clients.

Coleman (1999) examined whether loans accessed from MFIs by SMEs were effectively utilized by borrowers. He hypothesized that that the village bank credit did not have any significant impact on physical asset accumulation to the borrowers. The study found that credit was not an effective tool to help the poor out of poverty or enhance their economic condition. This trend was attributed to the fact that the proprietors ended up in a vicious cycle of debt as they used the money from the village banks for consumption purposes and they were also forced to borrow from money lenders at high interest rate to repay the village bank loans so as to qualify for more loans.

Bran and Woller (2010) carried out a study to establish the effects of microfinance in India. The study concluded that microfinance has brought better psychological and social empowerment than economic empowerment. The study further recommended that the impact of microfinance is commendable in courage, self-confident, self-worthiness, skill development, awareness about environment, peace in the family, reduction of poverty improving rural savings, managerial ability decision making process and group management. In other variables the impact is moderate. As a

result of participation in microfinance, there is observed a significant improvement of managerial skills, psychological well-being and social empowerment.

2.3. Conceptualization

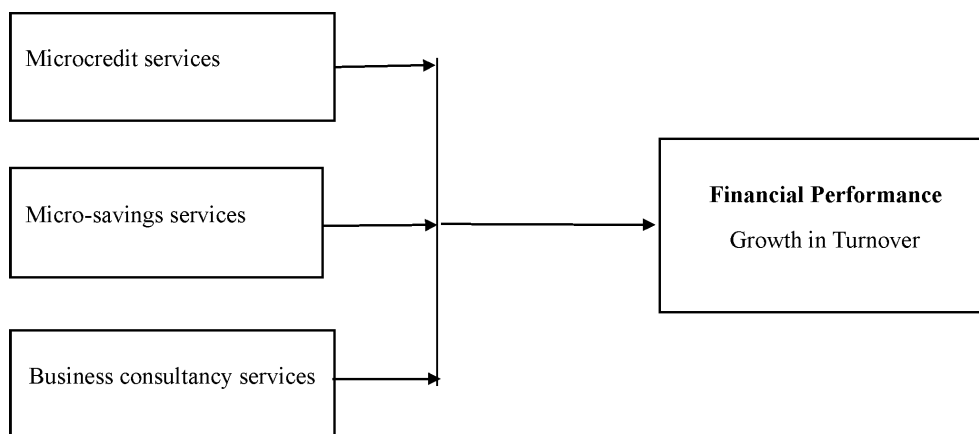The study was conceptualized as shown in the figure below:

Figure 2.1

3. RESEARCH METHODOLOGY

3.1. Research Design

The study adopted the descriptive survey research design. This research design was considered appropriate as it involved collecting cross-sectional data representing the opinions of the sampled respondents on the study variables. Since the study collected and analyzed data in the same status as it was, a positivist research philosophy was adopted.

3.2. Target Population

The study population comprised the MSMEs registered and licensed to operate within Kirinyaga County with the respondents being the proprietor managers of these MSMEs.

3.3. Sampling and Sample

The study used purposive sampling in selecting the geographical location of Kerugoya, Kutus, Kagumo, Sagana and Kagio townships as the main centers of the study. This decision was informed by the fact that these townships had the highest concentration of MSMEs; a factor that afforded the researcher the advantage of accessibility and a wider reach of MSMEs operating in different sub-sectors. According to the records obtained from the County government of Kirinyaga, a total of 6,090

MSMEs are registered to operate within the sampled townships. The research undertook a stratification of these MSMEs on the basis of the sectors in which they operate as follows:

Table 3.1: MSMEs licensed to Operate within the Selected Townships

Sector	No. of MSMEs	Percentage
Light manufacturing	80	6%
Agribusiness	481	35%
Transportation	66	5%
Merchandise trading	515	37%
Educational Institutions	42	3%
Repair & maintenance	75	5%
Others	134	10%
Total	1,393	100%

Based on the total entire population of 1,393 MSMEs, the study applied the Yamane formula to draw a sample of the MSMEs to be studied as follows:

$$n = \frac{N}{1 + N(e)^2} \text{ where}$$

Where n, N, and e represent sample size, study population (1,393), and margin of error (5%) respectively.

The above equation was substituted to estimate the sample size (n) as illustrated below:

$$n = \frac{1,393}{1 + 1,393(0.05)^2}$$

$$n = 310 \text{ MSMEs}$$

From the above stratification, the study used simple random sampling to draw the number of MSMEs to be studied within each stratum as follows:

Number of sampled MSMEs

Sector	No. of MSMEs
Light manufacturing	18
Agribusiness	107
Transportation	15
Merchandise trading	115
Educational Institutions	9
Repair & maintenance	17
Others	30
Total	310

3.4. Research Data

The study collected primary data on the variables using structured questionnaires which were administered using face-to-face considering majority of respondents required guidance in filling the questionnaires. The data comprised opinions by the respondents on specific statements which were designed based on an ordinal Likert-type scale with 5 depicting strong agreement and 1 representing strongly dis-agreement.

DATA ANALYSIS & MODEL ESTIMATION

Both descriptive and inferential statistics were used to analyze the research data. Descriptive statistical analysis using frequency distribution, measures of central tendency and measures of dispersion to provide a preliminary overview of the study population. Inferential statistical analysis involved estimating the specified regression model using the F and t-tests to determine the significance of the overall model and that of specific estimators. This was carried out at a 95% confidence level. The following multiple regression model was estimated by the study:

$$Y_i = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \mu_i \tag{1}$$

Where:

Y_i = Financial performance

β_0 = Constant term

$X_1 - X_3$ = The 3 explanatory variables of the study

μ_i = Random error term

$\beta_1 \dots \beta_3$ = Regression Coefficients of the independent variables.

i = Studied MSMEs

4. RESULTS AND DISCUSSIONS

4.1. Response Rate

The study administered 310 questionnaires, with one questionnaire issued to each respondent in the selected MSME. At the end of the data collection exercise, a total of 298 questionnaires were filled and returned. However, three questionnaires were determined not to have been appropriately filled and were therefore discarded. This gave a total of 295 appropriately filled questionnaires which accounted for 95% response rate. This was considered good for the study.

4.2. Descriptive Statistical Analysis

The ordinal data collected by the study was transformed into frequency distribution and the mean and standard deviations of the responses were derived. This enabled the

researcher to determine the extent to which the respondents agreed or disagreed with the research statements presented to them. Table 4.1 below represents the results of the analysis on both the independent and dependent variables.

Table 4. 1: Summary Statistics

Variable	Item	Mean	Std. Dev
Independent	Influence of Micro-credit services (X1)	4.235	0.243
	Influence of micro-savings services (X2)	3.812	0.321
	Influence of business consultancy services (X3)	4.031	0.164
Dependent	Growth in turnover	3.603	0.436

From the above analysis, it can be concluded that the respondents largely agreed that the micro-credit services extended to MSMEs by MFIs play a significant role in boosting their growth of revenue turnover (with a mean agreement level of 4.235 and standard deviation of 0.243). This was largely attributed to the fact that Microfinance credit was readily available to MSMEs without subjecting them to high collateral requirements and high interest charges as those demanded by mainstream banking institutions. This source of credit proved important in financing their operations; which guaranteed delivery of their sale orders to their customers.

It can also be deduced that the micro savings services offered to MSMEs by the MFIs contribute immensely to the growth of their sales turnover (mean agreement of 3.812 and std. dev. of 0.321). This was linked to the fact that MFIs provided avenues for constant savings by MSMEs which was often used as security to guarantee their borrowing. Further, the MFIs promoted the culture of savings among the MSMEs which provided relief to them during the time of need or peak business periods. This ensured continued business operations throughout the year and pushed up their sales turnover.

Finally, it can be established that the business consultancy services provided by the MFIs to the MSMEs are critical in the growth of their revenues (mean agreement of 4.031 and std. dev. of 0.164). Business consultancy comprised a variety of business support services extended to MSMEs by MFIs and included training on business management, financial literacy as well as business planning skills. These services came in handy to the owner-managers of MSMEs because they imparted them with critical skills to ensure better management of their businesses. The trickle-down effect of these services is to boost the revenue generation ability of these MSMEs. With regards to growth in revenue turnover majority of the respondents agreed that this growth is directly linked to services offered by MFIs.

Correlation Analysis

Table 4.2: Pearsonian Correlation Analysis Results

		Revenue growth	Micro-credit(X1)	Micro-savings(X2)	Consultancy services(X3)
Revenue growth	Pearson Corr. Sig. (2-tailed)	1	0.723	0.833	0.697
			0.031*	0.026*	0.019*
	N	295	295	295	295

From the results laid out in Table 4.2, the Pearsonian correlation coefficients shows a positive and significant relationship between the independent and dependent variables. The implication is that all the services offered by the MFIs were directly related with growth in revenues recorded by the studied MSMEs.

Multiple Linear Regression Analysis

Table 4.3: Regression Analysis Results

Dependent variable: Revenue growth				
Variable	Coefficient	Std. Errors	t-statistic	Prob.
Constant	3.621*	1.39	2.605	0.000
Micro-credit services	2.742	0.605	4.532	0.032
Micro-saving services	1.020	0.414	2.464	0.019
Consultancy services	0.837	0.728	1.149	0.0221
Statistics				
R-Squared	0.5753			
Rho	0.4119			
Wald-statistic (3)	210.20			
Prob. (Wald-statistic)	0.0000			
*Signifies the coefficient is significant at the 0.05 level				

The results displayed in Table 4.3 indicate that the studied explanatory variables jointly explained 58% of variations in the growth of revenues in the studied MSMEs in Kirinyaga County. Further, the Wald Statistic of 210.20 with a probability of 0.0000 evidenced that the overall model was significant at 95% level. The results show that all the 3 explanatory variables were positively related with growth in revenues as a measure of financial performance. The relationships were all statistically significant at 5% confidence level. The implication of this finding was that during the period of the study, increased provision of the three services offered by microfinance institutions led to a corresponding growth in sales revenues among MSMEs in Kirinyaga County.

This finding of the study mirrored those of the studies carried out by Cooper (2012) and Bran & Woller (2010) which found the services provided by Microfinance institutions among the SMEs to significantly influence their financial performance in Kenya and India respectively. The finding was nonetheless at variance with those provided by the study by Coleman (1999) which posited that microfinance services had no relevance to financial performance of SMEs in USA because the high interest rates charged on loans countered the prospective financial gains derived from these services.

5.   CONCLUSIONS AND RECOMMENDATIONS

Based on the findings discussed above, the study concluded that the microfinance services have a positive and significant influence on financial performance of MSMEs in Kirinyaga County. Following this conclusion, the study recommended that the owner-managers of the MSMEs in Kirinyaga County should have more strategic engagement with the Microfinance institutions in tapping the services extended by them. Further, the Microfinance institutions should strengthen their support to the MSMEs by among other things expanding the scope of the services offered to them in an effort to continue propagating their growth. Finally, the government, in realization of the immense contribution of microfinancing in the growth of the MSMEs should institute and implement microfinance- friendly policies in Kenya necessary to enable them continue supporting the budding MSME subsector.

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