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THE EFFECTS OF MICRO FINANCE LENDING CONDITIONS ON THE SUSTAINABILITY OF SMALL ENTERPRISES: A CASE OF LANGAS ESTATE, UASIN GISHU KENYA

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This study examined the effects of micro finance lending conditions on the sustainability of small enterprises in Langas estate of Uasin Gishu, Kenya. The study adopted theoretical framework which was based on Signaling and Agency theories. Stratified and simple random technique was used to select a sample of one hundred and twenty nine (129) respondents. Primary data was collected using structured questionnaires where the researcher sampled (129) respondents. However one hundred and eleven (111) respondents were able to successfully fill and return the questionnaires issued. Data was analyzed using descriptive statistics and findings are presented in frequency tables and percentages. Findings of the study show that there was an inverse relationship between sustainability of Small Enterprises and Microfinance Institutions services'. When lending conditions are in favor of the small business owners, sustainability improves by 0.376 (37.6%). The study concluded that, lending conditions were impeding entrepreneurs from accessing credit from the microfinance institutions and the study recommends that, microfinance institutions should not impose conditions that are unlikely to be fulfilled by borrowers wishing to access credit.

Key words: Micro finance, Small enterprises, Lending conditions, Entrepreneurs

1.0 INTRODUCTION

Microfinance traces its origins to 1976, when Dr. Mohammed Yunus started a small microfinance scheme as an experiment in the rural areas of Bangladesh as observed by Khan and Rahaman (2007). The experiment by Yunus evolved from its initial success into the Grameen Bank, the world's first microfinance institution, which popularized group lending, where loans were issued to individual members of small, homogeneous groups, who collectively guaranteed loans issued to their members. All members were barred from further access to credit in the case of default by one group member, providing strong incentives for the group to ensure repayment by each individual borrower. This microfinance model eventually spread around the world, especially in third world countries as asserted by Yunus (1976). Developing economies have been providing credit to the poor through microfinance institutions' schemes (Hulme & Mosley, 2009). The experience of several Asian, African as well as Latin American countries could be a typical example for this (UNCDP, 2003). In Africa particularly in Ethiopia, several microfinance institutions (MFIs) were established and have been operating towards resolving the credit access problem of the poor particularly to those participating in small scale business as observed by Berhane & Gardebroek (2011). Within any society, financial services provide a means for people and businesses to obtain credit and manage available assets on a continuous basis (Popov & Udell, 2012). According to Claessens (2006) access to financial services enables existing businesses to grow and provides starting capital for starter businesses. Microfinance institutions provide these services within communities that have limited resources and few avenues for development economically. People within these communities can use micro loans to develop small businesses based on their existing talents and skill sets and therefore access to credit plays a pivotal role in economic growth.

Banks and lending institutions provide the services that allow people to save and invest assets and resources which further supports and strengthen economic activity. Vetrivel & Kumarmangalam (2010) postulate that within underdeveloped communities, the role of microfinance institutions is to provide credit access and financial services needed to develop income earning businesses. Microfinance Institutions provide financial services to the Small Enterprises mainly in the form of micro credit with the exception of cooperative based Microfinance institutions which are predominantly savings based (Ledgerwood & White, 2006). The main microfinance institutions can be categorized as Non-Governmental Organizations (NGOs), Savings and Credit Co-operative (SACCOs), banks and Community Based Organizations (CBOs). Most Microfinance institutions with an exception of tiny rural based Savings and Credit Co-operatives are reluctant to extend their services to the rural areas due to poor infrastructure, high risk and high cost of operation (Kibas, 2004).

Sustainability is the process of increasing the capacity of institutions or groups to make choices and to transform those choices into desired actions and outcomes (Montgomery, 2005). Central to this process are actions which both build individual and collective assets, and improve the efficiency and fairness of the organizational and institutional context which govern the use of these assets. In order to ensure financial viability, sustainability needs to be central in the planning and day-to-day operation of the SME. As explained by (Cole and Mehran, 2011), Availability of credit remains a daunting challenge with most businesses expressing dissatisfaction with financial institutions in making credit available to do business. Lack of information on where to access professional and financial services is a major impediment for growth. Despite availability of products offered by financial and microfinance institutions, the targeted recipients are not informed on where to get them and how to meet requirements. Sustainability can be considered as an important dimension as it is a condition for achieving sustainability of other project components (Salman, 2008).

1.1 Signaling Theory

Signaling theory was introduced in 1974 by Michael Spence as a notion of signaling in economic thinking. According to him and as argued by Moss *et al*., (2015) when information is imperfect, individuals who possess strong qualities will send signals to distinguish themselves from others. It is useful for describing behavior when two parties' individuals or organizations have access to different information. Typically, one party, the sender, must choose whether and how to communicate (or signal) that information, and the other party, the receiver, must choose how to interpret the signal. Accordingly, signaling theory holds a prominent position in a variety of management literatures including strategic management, entrepreneurship, and human resource management.

Signaling theory is considered to be more insightful for some aspects of Small Enterprise financial management than others (Ahlers *et al.,* 2015). The emerging evidence on the relevance of signaling theory to small enterprise financial management is mixed. There has been no substantial and reliable empirical evidence that signaling theory accurately represent particular situations in SME financial management or that it adds insights that are not provided by modern theory. While the use of signaling theory has gained momentum in recent years, its central tenets have become blurred as it has been applied to organizational concerns. Signaling theory states that corporate financial decisions are signals that are sent by managers to investors so as to shake them up. Signaling Theory rests on the transfer and interpretation at hand about a business enterprise to the capital market, and the impounding of the resulting perceptions into the terms on which finance is made available to the enterprise.

Connelly *et al*., (2011) writes that of the ability of Small Enterprises to signal their value to potential investors, only the signal of the disclosure of an earning's forecast were found to be positively and significantly related to enterprise value amongst percentage of equity retained by owners, the net proceeds raised by an equity issue, the choice of financial advisor to an issue, and the level of underpricing of an issue. The signaling theory holds a prominent position in a variety of management literatures including strategic management, entrepreneurship and human resource management. The flow of funds between small enterprises and the microfinance institutions are therefore dependent on the flow of information between them, such as to enable the small enterprises to attain sustainability.

1.2 Agency Theory

The concept of agency theory originated from the work of Adolf Augustus Berle and Gardiner Coit Means, two American economists who began discussing corporate governance in terms of an "agent" and a "principal" as early as 1932. Berle and Means explored the concepts of agency and their applications towards the development of large corporations and they saw how the interests of the directors and managers of a given firm differed from those of the owner. They used the concepts of agency and principal to explain the origins of those conflicts. It addresses the relationship of agency, one of the oldest forms of social interaction. In an organizational context, the agency theory explains how best to organize relationships in which one party (the principal) determines the work, which the other party (the agent) undertakes. Eisenhardt (1985) presents the theory in two cases; the first one is characterized by complete information, when the behavior of the agent is observed and the actions and motivations are transparent. The solution to this scenario is a behavior based contract purchasing of services. However, such a scenario is less frequent due to the information asymmetry problem. The second case is characterized by incomplete information. The principal has limited information regarding the level of effort and the behavior of the agent (Mchembere *et al.,* 2017).

Agency theory is the branch of financial economics that looks at conflicts of interest between people with different interests in the same asset. It is the analysis of principal-agent relationships in which one person, an agent, acts on behalf of another person, a principal (Connelly, *et* al., 2011). Agency theory deals with the people who own a business enterprise and all others who have interests in it, for example managers, banks, creditors, family members and employees. The agency theory postulates that the day to day running of a business is carried out by managers as agents who have been engaged by the owners of the business as principals who are also known as shareholders. The theory is on the notion of the principle of two-sided transactions which holds that any financial transactions involve two parties, both acting in their own best interests but with different expectations. Agency Theory explains how to best organize relationships in which one party determines the work while another party does the work Agency argument is further explained by Wanyoike, (2013).

1.3 Lending Conditions on Sustainability of Small Business Enterprises

According to Kongolo, (2010) the development and sustainability of the small enterprises in the economy is of paramount importance if the dream of wealth creation is to be realized at all. The main sources of credit to small enterprises are relatives and friends, formal banks, Microfinance Institutions and personal savings. There has been a lot of emphasis on provision of financial services to small enterprises in form of credit. Despite catalytic role expected to be played by Microfinance Institutions in facilitating economic growth through small enterprises, the enterprises have continually faced persistent barriers in accessing funds for investments. Adopting sustainability practices can make smaller entities more competitive (Leatherman *et al*., 2011). Strategic integration of sustainability assists small enterprises to better anticipate and respond to long term trends and the effect of resource use, while addressing stakeholder expectations. Small enterprises that embrace sustainability in business have a better understanding of the impact of systemic risk and resource constraints on business operations. Identifying and addressing environmental and social concerns related to products and services can be a differentiator in certain markets, while opportunities for business innovation can be realized when environmental and social challenges are seen as opportunities to meet society's needs (Rosengard *et al*., 2000).

According to World Bank (2010), there are some 900 micro credit institutions in 101 countries that offer loans to the world's poor and these are some of the oldest, largest and most stable of such organizations. In a sample consisting of 206 of this micro credit organization, it was reported that they had issued 145 million loans with a collective loan portfolio of over U.S$7 billion (World Bank, 2010). Micro finance is one of the most recent and innovative strategies of addressing the global poverty. Micro enterprise creation and development and micro finance are not the classical hand-out mentality that has dominated most development approaches in the past. According to Ondiege (1996), research reports indicate that a majority of the Small Enterprises generally have some common characteristics, for example, observes that most Small Enterprises in Kenya are labour intensive, use relatively cheap tools and equipment, use second-hand and locally fabricated machinery, operate in small scale and have a low capital start-off.

Otunga *et al*., (2001) concurs with this, asserting that unlike capital-intensive large-scale enterprises, the Small Enterprises are labour intensive and this makes them provide more jobs, each day they are created. Limited access to credit is commonly identified as a key constraint to Small Enterprise growth, but little evidence exists of the direct and indirect effect of loans on small firms in a given market. Small businesses are often thought to be an important source of employment, innovation, and economic growth. In many developing countries, small and medium enterprises make up a large share of registered businesses, but a much smaller share of GDP. Data from several countries suggest that few small enterprises grow to become larger businesses. One reason could be that unlike larger businesses, small enterprises have limited access to credit, preventing them from making larger investments to improve their operations, upgrade to new technologies, or expand.

Most small enterprise financing needs exceed the small loans that microfinance institutions provide. Yet, larger commercial banks often find it too expensive to lend to small enterprises because the cost of assessing whether an SE is creditworthy is highly relative to the return banks could earn by lending to them. Many banks also perceive small enterprises as being too risky and more likely to default on loans. Credit scoring has been used extensively in developed countries to reduce the cost and time required to process loan applications and to assess the riskiness of loan applicants in order to make small business and consumer lending profitable for banks (Dondo, 1999).

In Kenya, the economic update indicates that although financial inclusion is increasing and Kenyan banks are ahead of their counterparts in terms of the share of lending to small enterprises in their portfolios, the high cost of credit is constraining the growth of Small Enterprises. This corroborates data by the World Economic Forum (WEF) which shows that Kenyan businesses cite access to financing as the second most problematic factor in doing business.

2.0 RESEARCH DESIGN AND METHODOLOGY

2.1 Research design

The research adopted a survey research design which was suitable for collecting facts, views, opinions, attitudes and suggestions from the respondents on the effects of micro-finance institutions on sustainability of small enterprises in Langas Estate. This research considered the survey research design more appropriate for collecting and analyzing the relevant data. According to Mugenda and Mugenda (1999), the survey research design is used to collect data on what people say on a given phenomenon by use of questionnaires and interviews.

2.2 Sample Size and Sampling Procedures

This study applied stratified and simple random sampling technique. Mugenda and Mugenda (2003) argue that random sampling is the key to obtaining a representative sample. The researcher used data from the Uasin Gishu County Government, Department of Commerce and Industry and obtained a published list of licensed small enterprises captured by the department which enabled him to stratify the listed enterprises categorically. Out of the many existent small enterprises in Langas Estate, the list only comprised of licensed enterprises. This guided the researcher in forming the strata for the study. 30percent of the target population was then used to arrive at the sample size; this is because the sample size which the researcher sought to get was manageable to collect data and as supported by Mugenda and Mugenda (1999).

Table 1 Sample Frame

Category	Target Population	Percentage	Sample Size
Salons and Boutiques	90	30percent	27
Shoe Shiners and Repairs	70	30percent	21
Newspaper and Book Vendors	50	30percent	15
Hotels and Eateries	100	30percent	30
Kiosks and Shops	120	30percent	36
Total	**430**		**129**

Source: Uasin Gishu County Government (2014)

Mugenda and Mugenda (2003) formula was used as presented below:
Sample size is calculated as:

$$nf = \frac{n}{1+(n)N}$$

Where: nf = the desired sample size
n = the desired sample size when the population is more than 10,000
N= the estimate of the population size
Therefore, 129 respondents from the selected small businesses were selected.

2.3 Data collection

The researcher used questionnaires to collect the data. The questionnaire was the most appropriate research tool as it allowed the researcher to collect information from a large sample with diverse background; the finding remained confidential, saved time and since they were presented in paper format there was no opportunity for bias (Kombo *et al.*, 2006).

2.4 Data Analysis

Before processing the responses, the completed questionnaires were edited for completeness and consistency. The data was then coded to enable the responses to be grouped into various categories. This research later employed quantitative methods of analyzing data. In analysis, ratio scale was used in data measurement and both inferential and descriptive statistics were used to analyze the data. In descriptive statistics, the research employed descriptive statistical tools computed by the Statistical Package for Social Sciences Version.17 which helped to describe the data and determine the extent used, use of graphs, pie charts and tables to present data.

3.0 RESULTS AND DISCUSSION

3.1 Capital Outlay

Respondents were asked to indicate on average their business worth in terms of capital invested. Findings of this item were presented in Table 2.

Table 2: Capital Outlay

Size of Capital	Frequency	Percent
1000- 5000	30	27
5001- 10000	44	40
10001 -20000	20	18
Above 20001	17	15
Total	111	100

The study established that, majority of the enterprises had a capital outlay of between 5001- 10000 as indicated by 40 percent. 27 percent had a capital outlay of between 1000-5000. 15 percent had a capital outlay of above 20001 while 18 percent had a capital outlay of between 10001 and 20000. These findings further indicate that the enterprises were small scale businesses. According to (Wiklund, 1999), growth in assets is a useful sustainability measure that has been considered. The amount of capital invested usually tells more on a business' financial capability.

3.2 Sustainability Overtime

Respondents were required to rate the sustainability of their enterprises overtime based on revenue generation, profits, capital fluctuations and employee turnover. A four point likert scale was used to measure sustainability. Findings are as indicated in Table 4.5.

Table 3: Sustainability Overtime

Indicators of sustainability	VS	S	US	VUS
Monthly revenue	10	20	79	2
Profits	0	11	1	99
Employment rates	77	23	11	0
Accumulation of stock/ capital	50	60	1	0
Mean	34	28	22	27
Percent	31	25	21	23

3.3 Lending Conditions and Sustainability

Respondents were asked to indicate the lending conditions that microfinance institutions impose on small enterprises.

3.3.1 Access to Loans

Respondents were asked to indicate whether they were accessing loans from microfinance institutions. Findings are presented in Table 4.

Table 4: Access to Loans

Response	Frequency	Percent
Yes	77	69
No	34	31
Total	111	100

Source: Field Data, (2014)

The study established that, majority of the respondents were accessing loans as represented by 69 percent. 31 percent on the other hand cited that they were not receiving loans from MFIs. Respondents further indicated that, lending conditions were not in their favor as they lacked collateral, made unstable profits and revenues to be able to qualify for loans. Having established that respondents were facing lending conditions, the researcher was keen to establish respondents' level of agreement concerning the existence of lending conditions among microfinance institutions.

CONCLUSION

The study established that, on average, majority of the enterprises had achieved sustainability even though they were facing problems. This is indicated by 31percent of the enterprises whose owners indicated that they were very stable regarding revenue generation, profits, employment rates, and accumulation of stock overtime. 25 percent further cited that their enterprise were stable in terms of performance. 23 percent cited that their enterprises were very unstable while 21 percent cited that their enterprises were unstable. The researcher further noted that, monthly revenue and profits were generally unstable for a good number of the enterprises. These findings are in agreement with Wiklund (1999) that marinating revenues and profits are a challenge to each and every business enterprise.

The study established that, majority of the respondents were accessing loans as represented by 69 percent. 31percent on the other hand observed that they were not receiving loans from MFIs. Respondents further indicated that, lending conditions were not in their favor as they lacked collateral, made unstable profits and revenues to be able to qualify for loans. The study established that there was a significant relationship between lending conditions and sustainability of Small Enterprises as shown by P value (0.000) being less than 0.05, $P < 0.05$. Multiple regression results also indicated that when lending conditions improved, sustainability improved by 0.376 (37.6 percent). This is because respondents cited that, lending conditions were impeding them from accessing loans from Microfinance Institutions. Lack of loans may have hindered capital accumulation, increase in profit margins, low employment rates and generally low average revenues.

The research noted that, according to the respondents, lending conditions that bore more weight on access to loans include; lack of full financial support by microfinance institutions, need for collateral when giving borrowers loans, limiting the size of credit and processing loans within a short time. Lending conditions may impede borrowing by small enterprises since they may not be in possession of the necessary requirements. As (Dondo, 1999) notes that unlike larger businesses, small enterprises have limited access to credit, preventing them from making larger investments to improve their operations, upgrade to new technologies, or expand. Credit enables larger investments to improve operations, upgrading to new technologies, or expanding business which in return enable sustainability of Small Enterprises. Since some enterprises were not accessing credit, it is likely that lending conditions were barring them from accessing credit and lack of credit may have led to sustainability problems of the enterprises.

SUGGESTIONS FOR FURTHER STUDY

Microfinance institutions should not impose conditions that are unlikely to be fulfilled by borrowers wishing to access credit. This way, they will make more profits by lending to more people and entrepreneurs will as well make investments. Microfinance institutions should rather improve on their credit recovery strategies. Future researchers should further consider other externalities such as government policies regarding the working of microfinance institutions and how it affects microfinance institutions.

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