MICROFINANCE SERVICES AND FINANCIAL PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES IN NAIROBI CITY COUNTY, KENYA

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ABSTRACT

Micro-financing performs a fundamental function in the sustenance of small and medium enterprises as they serve as supporting vessels in issuing start-ups to small and medium enterprises particularly, to rural unbanked population. Despite this vital role, about 70% of these firms are in the trading sector experiencing numerous hurdles that have slowed their growth and development among which include insufficient operating capital, insufficient industry knowledge, outdated technologies, a lack of company expertise, and lack of production facilities. How microfinance services affect the small and medium-sized businesses financial performance in Nairobi City, Kenya, was the main focus of this inquiry in light of the surrounding circumstances. Specifically, this investigation will determine microfinance credit services effect on small and medium enterprises' financial performance in Kenya under the context of Nairobi City. The inquiry was anchored on credit rationing theory and resource-based view. The target demographic sample in this study was 120 Small and Medium Enterprises owners which were arrived at via random sampling in Nairobi City. The research was based on descriptive research design. Primary data utilization was adopted and sourced through questionnaires. Checking of the instruments, validity and reliability was necessary. Evaluation of the information was via descriptive statistics including mean, frequency and percentage, and inferential analysis which includes correlation analysis and multiple regression analysis. The utilization of diagnostic tests such as heteroscedasticity, normality and multicollinearity checked the assumptions of regression analysis. The outcome of analysis was presented using tables. Ethical principles relating to research were duly observed. Discovery from the survey indicated that credit services positively and significantly affected SMEs financial performance and therefore rejected the null hypothesis. The study recommends its increase to boost SME financial performance in Nairobi City, Kenya. This will help improve the level of the SMEs financial performance in the city of Nairobi, Kenya.

Key words: Microfinance Services, Credit Services, Savings Services, Insurance Services, Training Services and Financial Performance.

INTRODUCTION

Small and medium businesses have contributed to countries' financial aspirations around the world, and its progress is critical for dynamic marketplaces, competency, manpower uptake, and product retention. In effort to match ultimate industry priorities, some components are presumed to be linked through required work efficiency improvements as well as other sections initiatives like creation of an empowering legal and method outline, opportunities of direct connections to market segments, financial assets, providing certifications, infrastructural facilities, institutional support, taxes, and innovation adaptive responses (Mumbua, 2020). Microfinance services are set up to raise funds and offer finances for micro and small businesses, low-income people, and other types of organizations. These financial services can be spread across a variety of services to include payment and insurance services, in addition to the typical financial services of savings and credit.

The rate of mortality of SMEs majorly amongst African countries continues to be at a very high rate as in seven newly established businesses five tends not to survive in the first year of their existence. In Uganda, one-third of the new businesses that are just starting do not survive operationally for more than one year. Based on the industry in South Africa, SMEs tend to fail at a rate of 50% to 95% (Willemse, 2010). In Chad, a failure rate of 65% has been observed among SMEs and it has been noted to be among the countries with difficult regulatory frameworks that makes it unfavorable for businesses to thrive (World Bank, 2020). In most African countries, the unpleasant business environment due to several increases in taxes, stringent legal requirements, fluctuating exchange rates as well as inflation has made it really difficult for SMEs to thrive (Willemse, 2010). When ranked, Africa happens to be below countries such as Middle East, Central and East Asia, Latin America, Eastern Europe, North Africa and South Asia.

In Kenya, nearly 70% of SMEs work in the trading sector, which involves commodities' purchase and sales to make money. 13% of SMEs falls within the manufacturing sub-sector, 15% in the services sub-sector while 6% of other services which comprised of hotels, bars and restaurants. Construction companies constituted fewer than 2% of all SMEs in the country. SMEs in Kenya, have experienced numerous hurdles that have slowed their financial performance and growth. Insufficient operating capital, insufficient industry knowledge, outdated technologies, lack of company expertise, and lack of production facilities are just a few of them (Nyuanumba, 2017).

Statement of the Problem

Manufacturing, trade, and services are just a few of the industries in Kenya where SMEs are prevalent. SMEs range from unregistered Jua-Kali ventures to fully registered small businesses including supermarkets, wholesalers, and transportation firms. Ten thousand Kenyan shillings (KES) to around five million KES have been invested in SMEs (MESPT, 2014). Small and medium scale firms are a broad category of companies in Kenya that operate in a wide range of social and economic contexts and have varying levels of sophistication. Examples of these companies include small eateries, machine shops, and software companies. The business owners may be wealthy; some are inventive, energetic, and growth focused, while some are life styled traditional businesses content to remain small (Woodirad, 2020).

In Kenya, it has been noted 2.2 million SMEs have shut down during the last five (5) years. It was observed that most of the shutdown businesses which include retail and wholesale trade likewise motor vehicles and motorcycles repair sectors accounts for about 73% of the entire closure. Although, SMEs performs a central part in the country's development of the economy, their performance still remains a problem financially due to the fact that a lot of them fail to bounce back up; three (3) out of five (5) SMEs tend to fail within a very short period of time after their start up (Githie & Muturi, 2015). In Kenya, majority of the SMEs fail due to their poor performance and their failure rate tends to be very high. Most SMEs in Kenya however do not develop into very large enterprises and their failure is usually associated with various social crimes, insecurity and job losses (Githre & Muturi, 2015). The estimated value of SMEs' output in 2015 was Ksh3, 371.7 billion, or 33.8% of the country's total output of Ksh9, 971.4 billion. A total of 2.2 million SMEs were closed down between 2011 and 2016. The reason is tied to the many SMEs that are faced with an array of challenges in their operations which in turn affect their financial performance.

Many studies have been undertaken previously on microfinance services effect on Kenya's SMEs financial performance. In Meru Town, Meru City, Kenya, on the SMEs financial performance, Mutuma and Omagwa (2019) look into the effect of the services of microfinance lending. Microfinance institutions effect on Kenya's Kitui City SMEs financial performance was the subject of Mumbua (2019) investigation. Using a qualitative method, Ibrahim (2017) looked at the effects of financial education on micro and small firms' performance run by Kenyan students in the university. In Ghana's Sekondi-Takoradi metropolitan area, Amoah (2020) investigated the manner through which micro-insurance determine SMEs financial performance. These studies were carried out in different environmental settings; therefore, this study aims at looking at Nairobi City. By analyzing how the effect of Nairobi City SMEs financial performance is felt by microfinance services, this investigation aims to close the gap.

Objective of the Study

To investigate the effect of microfinance services on the financial performance of SMEs in Nairobi County, Kenya.

Specific Objective

i. To determine the effect of microfinance credit services on the financial performance of SMEs in Nairobi County, Kenya.

THEORETICAL REVIEW

Credit Rationing Theory

The advancement of credit rationing hypothesis was made possible by Matthews and Thompson (2008). According to Keiding (2015), financial institutions are mainly private businesses that are directed by the goal of profit maximization. In comparison to this goal, not everyone who seeks money receives it. As a result, the loan market isn't in great shape throughout the price mechanism. Borrowers may be denied credit even if they are willing to invest at arbitrarily high interest rates, according to Wright, Westhead, Stone, Akuetteh, and Robson (2013). The credit market differs from the conventional financial sector, where supply and demand are equal, because borrowers who are ready to accept higher interest rates may have trouble making payments. According to Tirole (2010), this occurs because borrowers are unable to successfully repay the loans plus interest due to the high interest rate.

When the expected profits from credit by microfinance companies are lower than the banking institutions' expectations, credit restriction occurs (Ghosh, Mookherjee & Ray, 2000). The critical elements or factors contribute to the non-monotonic relationship between expected return shipping and interest rates: When interest rates are unable to separate ready borrowers from the rest of the market, the detrimental choice impact arises. This is the group of borrowers who can accurately assess their plans and activities within safer stated objectives (Steijvers & Voordeckers, 2009). Borrowers have been observed to leave the industry if interest rates rise above their expected profits. The financial institution regards individuals who request higher interest rates to be significantly more risky. According to Hellman and Stiglitz (2000), the negative motivator (moral hazard) effect states that an increase in interest rates causes borrowers to choose riskier projects, putting the financing organization's required return at risk or possibly increasing the possibility of a bad loan portfolio.

Credit restriction, according to Matthews and Thompson (2008), is commonly done on purpose to protect financial firms from imminent hazards. If financial institutions are unable to control risks that may arise from the implementation of free market principles, they may choose to allocate credit, despite the borrowers number who are willing to recompense the loan with a rate of interest that is higher. This notion is used to describe the financing gap that may arise within microfinance services. In Kenyan markets, SMEs financing ideally is a challenging proposition. The hypothesis was beneficial in determining the needs of microfinance services, particularly credit to SMEs, and the way these criteria has an effect on SMEs' financial performance.

Resource Based View Theory

Barney (2001) is given credit for the theory. Every business has a wide range of tangible and intangible assets (Barney, Wright & Ketchen, 2001). Barney contributed late to the Resource Based View by conducting a study and presented evidence of the availability of essential organizational resources for exceptional performance. The Resource Based View hypothesis is predicated on the idea that people are driven to optimally utilized the economic resources at their disposal, as well as on the idea that businesses make sensible decisions as a result of the economic environment (Barney, 2016). In this study, the theoretical idea is utilized to evaluate and describe the resources and capabilities potentially possessed firm that establish and preserve the advantage of a firm and hence good productivity in the Kenyan mobile phone industry (Sheehan and Toss, 2016). What constitutes capacity are complex sets of abilities, acquired expertise, aptitude, and training that enable a corporation to manage its activities and ensure the utilization of resources to achieve performance by putting and coordinating resources into efficient productive utilization (Amit and Shoemaker 1993; Barney, 2016 and Mckelvie and Davidsson, 2013).

Resource Based View, according to Lockett, Thompsons, and Morgensrern (2013) on performance leadership, examines the resources and abilities that enable the organization to provide above-average earnings and higher performance advantages. The Resource Based View idea aids business owners in determining whether or not components in relation to superior performance exist. This enables them to enhance their performance by taking advantage of market flaws. The goal is to put managers in a situation where resources can be pooled to keep competitive edge. The hypothesis is of great essence in that it points out factors that improve the firm's performance, thus attributing the company's advantageous position to the available resources (Locket, Thompson & Morgenstern, 2013). The proposition assists executives in choosing the strategic component that is of utmost priority to invest by giving a list of potential strategic variables in the industry of the mobile phones. Resource Based View has benefited operational efficiency by highlighting firm-specific resources as an actual source of high performance (Mckelvie & Davidsson, 2013).

Resources and capabilities must be extremely precious, uncommon, inimitable, and non-substitutable in order for a company to do well. Resources that are valued contribute to the firm's success. Because the resources in that category are possessed by fewer enterprises, rarity creates optimum competition. Inimitable resources are hard to emulate and non-substitutable, implying that competitors will not be able to perform an equivalent function in the same time frame (Barney 2016, Barney and Hesterly, 2010). Physical things that a business owns, such as facilities, commodities, and technology, are known as tangible resources. Business trade identity, business ideals, connections, and procedures are examples of intangible resources that are not reflected in traditional management accounting data. When contrasted to tangible assets, intangible assets are more apt to provide significant position and greater performance (Rouse & Daellenbach, 2014 & Kenneth at el., 2011).

Empirical literature Review

Microfinance Credit Services and Financial Performance

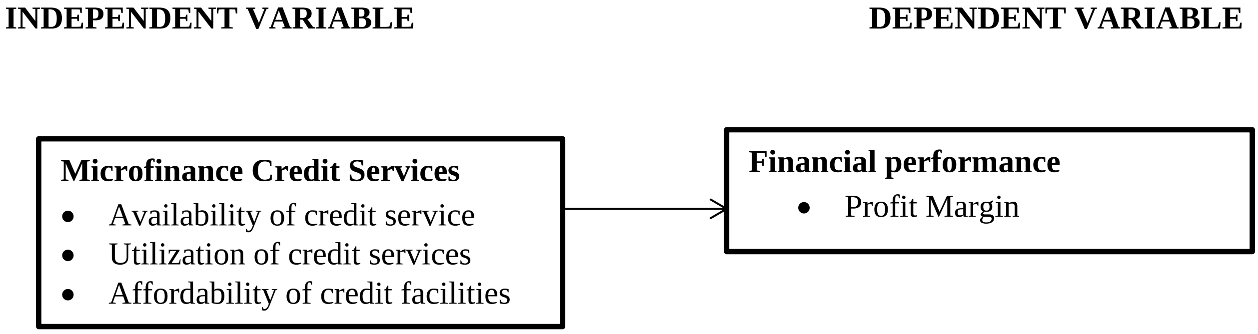
In Meru Town, Meru City, Kenya, Mutuma and Omagwa (2019) investigate microfinance lending services impact on SMEs' financial performance. Descriptive research plan to gather data on the accessible state of the event and to explain "what exists" on variables in a given circumstance was utilized. A total of 93 people were surveyed. The utilization of a questionnaire in information collection was eminent. Using multiple regression and descriptive statistics at a level of 0.05 significance level, discovery showed a significant association of Microfinance Services with SMEs financial performance, which is credit facilities (p-value= 0.034). According to the data, respondents highly agreed that microfinance lending services assisted in boosting the number of entrepreneurs who established new businesses. This study focused on SMEs in Meru City while Nairobi City will serve as this investigation ground.

Mumbua (2019) investigates how lending facilities impact on the Kitui City SMEs financial performance in Kenya. The survey employs a descriptive design in which the information generation tool was the questionnaires from respondents who were chosen. The completed questionnaires were examined and modified to suit the inquiry. The inferential statistic was used in regression evaluation to emphasize the type and strength of the connections formed with the independent and dependent and intervening variables. Credit availability has a favorable and an impact that is significant on financial success. The study was carried out on SMEs in Kitui City as against Nairobi City's SMEs.

Madaraa, Onyango, and Nyagol (2020) looked into the impact of microfinancing on entrepreneurship performance in a few counties in western Kenya. Microcredit under Micro Financing Services was investigated in the study. The study addressed 65,698 MSEs, of which 398 were chosen as a sample. The goal of the investigation was to see how microfinance credit services affected MSE performance. To acquire primary data, the researchers used a descriptive survey methodology and organized questionnaires. Statistical software (SPSS) was employed to evaluate the information, which was then demonstrated in descriptive and inferential statistics. The survey discovered that independent variables such as access to microcredit and savings mobilization explain a substantial fraction of the variation in MSE performance. Microfinance contributes to MSE growth and expansion was found. The inquiry focused on Entrepreneurship performance in the western part of Kenya, this study will focus on SMEs financial performance in Nairobi City, Kenya.

Conceptual Framework

Figure 1: Conceptual Framework



Source: Researcher (2023)

Research Design

Descriptive investigative design was accorded this research. In the views of Mugenda and Mugenda (2013), descriptive research entails a survey that aims to collect information from a demographic to determine the participants' current state in relation to the parameters. Therefore, this design served the purpose of this survey to determine the relevance associated with microfinance services, hence making it appropriate for the study.

Target Population

The target demographic comprised of 120 SMEs owners offering trading services in Nairobi City because the trading sector constitute 70% of the total SMEs in Nairobi City (GOK, 2018). Thus, SMEs that comprises of bookshops, grocery shop, flower shop, mobile phone shop, jewelry shop and clothing and accessories shops were examined.

Sampling Design

The investigation's population which is considered as small would warrant the use of census where the need for a subset would be void and unnecessary. As a result, there were 120 SMEs owners offering trading services in Nairobi City.

Data Collection Instruments

Questionnaire was the information gathering forms the respondents who had been chosen. As the inquiry employed a questionnaire, it determined the quantum of available data, nature and the objectives that influenced the design of the questionnaires. To gather information, primary information sourced. These questions were managed as part of the drop and pick process.

Data Collection Procedure

Request for a study authorization from the National Commission for Science, Technology, and Innovation (NACOSTI) as well as institutional approval before traveling on field visits to collect data was sorted by the researcher. After receiving authorization, the participants were provided with the questionnaires along with a letter to guarantee the data collection process. The researcher administered the questionnaires to each respondent on an individual basis. All questionnaires provided to participants were carefully monitored and ensured to be completed. The questionnaires that were delivered and received were recorded for the study.

Data Analysis and presentation

The survey instrument was examined and modified for comprehensiveness, competency and accuracy once they had been finished. The replies were coded, and data was entered into the 23rd version of Statistical Package for Social Science (SPSS). To demonstrate the link between variables, regression and correlation analysis was used. After that, the information was processed and illustrated using tables and graphs. The type and strength of the relationships involving the independent, intervening, and dependent variables was ascertained via the application of regression analysis which was shown by the inferential statistic.

Regression model was adopted to evaluate the factors that influence the SMEs' financial performance of in Nairobi City, Kenya.

The regression model that was used is as follows:

$Y = \beta_0+\beta_1X_1+\varepsilon$

Where:

Y = Financial Performance

X_1 = Microfinance Credit Services

ε = Stochastic Variable

$\beta_0 \dots \beta_1$, = Coefficients

RESEARCH FINDINGS AND DISCUSSIONS

Descriptive Statistics

Table 1: Microfinance Credit Services Descriptive Statistics

N = 114							
Statement	Percentage					Mean	S.D
	1	2	3	4	5		
Microfinance credit are readily available for your type of business	0.9	2.0	1.7	37.7	57.7	4.5188	.7627
Credit facilities are expensive	1.4	2.6	9.9	58	28.1	3.9246	.8177
Microcredit requires collateral and so many documentation	3.5	2	9.3	57.4	27.8	3.9449	.8317
Microfinance credit application are fast	2.9	1.4	8.7	59.7	27.2	3.9159	.7749
The business as utilized credit facility	2.3	3.5	11	57.1	21.4	4.0058	.8793
Microfinance credit services has improve financial performance of the business	6.7	11	24.3	46.7	19.1	4.0754	.8784
	Average Mean = 4.0642 Std. Dev. = 0.8241						

Source: Field Study (2023)

Credit services of microfinance institutions are critical to the welfare upliftment of the citizens in Nairobi City, particular in enhancing the small business growth. With an informed knowledge of the respondents responses on credit services of microfinance institutions, it was revealed that a large chunk of the survey participants are of the strong opinion that microfinance credit are readily available for the business type run by these owners as shown by a mean score of 4.5188. The follows that the credit facilities assessed by the SMEs owners in Nairobi City as observed by most of the research participants revealed a mean value of 3.9246 to confirm the expensive nature of the credit facilities accessed by the entrepreneurs. With a confirmation of a mean score of 3.9449 to indicate that many of the respondents concurred to the idea that microcredit requires collateral and so many documentation in Nairobi City. This is to say that the process through which microfinance credit is assessed is fast noting the agreement of the business owners with a mean score above 3.0. Thus, the opinions of the field studied participants aligned with the statement that the utilization of credit facilities by the owners of these businesses is eminent to observing with great extent to agreement with a high number of responses as noted by 4.0058 average mean score. In view of a larger number of the respondents as signified by a mean score of 4.0754, microfinance credit services has improve financial performance of the business. Adding up the average sum of the mean score of the businesses in Nairobi City with regard to microfinance credit services, a decisive mean threshold of 3.0 was set up where the realization of a mean score of 4.0642 confirmed the fact that microfinance credit services determine SMEs financial performance in Nairobi City, Kenya.

Table 2: Financial Performance Descriptive Statistics

N=114							
Statement	Percentage					Mean	Std. Deviation
	1	2	3	4	5		
The business profit margin has increased through microfinance services	4.1	2.3	9.3	51	33.3	4.1275	.8324
Microfinance services has improved the business	3.8	3.2	11.3	66.1	15.7	4.2551	.8950
Sales has also increased	5.8	3.8	15.9	61.2	13.3	4.2464	1.0116
Average Score	Average Mean = 4.2097 Std. Dev. = 0.9130						

Source: Study Data (2023)

Keeping in view the performance of the small businesses in the city of Nairobi, most of the entrepreneurs who responded to the claims on the questionnaire observed with a mean average score of 4.1275 that the business profit margin has increased through microfinance services. It is right to say therefore, that the services provided by the microfinance institutions provide leveraging ground for small businesses to accelerate within the competitive environment. Observing from a mean score average of 4.2551 which is high and above the 3.0 threshold meaning that many of the respondents are in agreement that microfinance services has improved the businesses in Nairobi city. Due to this, the claim that sales has increase also from the services rendered by the microfinance institutions is validated in strong terms owing to the mean average score of 4.2464. The responses of the respondents are in line with the composite mean 4.2097 which is greater than the 3.0 threshold used in the survey thus, implying that the services offered by microfinance institutions significantly influences the financial performance of the city of Nairobi's SMEs in Kenya.

Correlation Analysis

The researcher created a correlation matrix between the variables utilizing the SPSS software. The results are summarized in Table 4.

Table 3: Correlation Results

		Financial Performance	Credit Services
Financial Performance	Pearson Correlation	1	.332**
	Sig. (2-tailed)		.000
Credit Services	Pearson Correlation	.332**	1
	Sig. (2-tailed)	.000	

Source: Field Data (2023)

The correlation analysis of the variables used in the experiment was displayed as a result in Table 4.12. The results of the investigation demonstrated a positive and significant association between the financial performance of SMEs in Nairobi City County and the provision of credit services.

Regression Analysis

Multiple regressing analysis was computed to derive the relationship between the variables.

Model Summary

Table 4: Model Summary

Model	R	R Square	Adjusted R Square
1	.739[a]	.692	.683

Source: Field Study (2023)

The financial performance of SMEs in Nairobi City, Kenya, and microfinance services are positively correlated, as revealed by the R value of 0.739. The R-square of 0.692 demonstrates that only 69.2% of the variability in the SMEs financial performance in Nairobi city was explained by microfinance services (credit services, saving services, training services, and insurance services). This indicates that the individual factors account for 69.2% of changes in SME financial performance. Therefore, the explanatory variables included do not fully explain 30.8% of the variation in the dependent variable.

Analysis of Variance (ANOVA)

The ANOVA test was done and the results shown in Table 6.

Table 5: ANOVA

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	38.489	4	9.622	6.550	.007[b]
	Residual	161.639	110	1.469		
	Total	200.128	114			

Source: Field Study (2023)

Table 5 represented in the form the outcome of the analysis of variance (F-statistic). The F value showed whether or not the independent factors have a significant dependent variable impact. F statistical value of 6.550 was shown. Findings also showed that the significance (p=0.007) of the F value was evident at the 5% asymptotic significance level in view of the confidence of 95% level. This indicates that the Nairobi city's SMEs financial performance is significantly impacted by the combination of credit services, saving services, training services, and insurance services. This indicates that all the explanatory factors taken together contain an influence of significance on the financial performance of SMEs in Nairobi, Kenya.

Regression Coefficients

The regression output was done and represented in Table 6.

Table 6: Regression Results

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-.042	.201		-.210	.834
	Credit services	.229	.087	.155	2.645	.009

Source: Field Study (2023)

$$FP = -0.042 + 0.229X_1 + \varepsilon$$

Where:
FP = Financial performance
X_1 = Credit Services
As shown in Table 6, the inquiry's outcomes revealed the effect which every explanatory variable has on the financial performance of SMEs. Values of standardized beta, which depict the effect of each independent variable on the dependent variable, demonstrate this effect on FP. The intercept of the regression estimate is negative with a value -0.042 with a corresponding p-value of 0.834 higher than the 0.05 significance level.

Microfinance credit services revealed a positive coefficient value of 0.229. The positive value is accompanied by a significant p-value of 0.009 less than 0.05 significance level adopted in the survey. Based on the outcome of the investigation and following from the null hypothesis which says that microfinance credit services has no significant effect on the financial performance of SMEs in Nairobi City, the product of the estimation showed that the null hypothesis is rejected. This demonstrates that the credit services provided by microfinance institution is important to the determination of SMEs financial performance in Nairobi City. The outcome could be linked to the fact that small businesses are owned and control by small income earners in Nairobi thereby, making it easier for microfinance institutions to offer credit services to the business owners since they are established majorly to boost the income of the low earners and small businesses. The outcome corroborates with that of Mutuma and Omagwa (2019) who established that a significant association of Microfinance Services with SMEs financial performance, which is credit facilities. Mumbua (2019) found that credit availability has a favorable and an impact that is significant on financial success.

CONCLUSION AND RECOMMENDATIONS

Conclusion

The study's findings show that credit services significantly improved the Nairobi city SMEs financial performance. In view of this finding availability of credit service, utilization of credit services and credit facilities being affordable and easy to get influence Nairobi city SMEs financial performance. This suggests that addressing microfinance credit services improves the Nairobi city SMEs financial performance. Microfinance credit services enables credit-deprived households and SMEs to access loans, streamline cash flows, and fuel growth, while also serving as a crutch to cope and rebuild during a financial crisis.

Recommendations

Regarding the manner through which microfinance services affect the city of Nairobi SMEs financial performance, suggestions are offered. Based on the survey's findings, which indicated that credit services had a significant and positive effect on SME financial performance, the research suggests that credit services be increased in order to boost SME financial performance in Nairobi City, Kenya.

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