

**INFLUENCE OF CAPITAL STRUCTURE ON  
FINANCIAL PERFORMANCE OF CRAFT MICRO  
ENTERPRISES IN KENYA**

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**Influence of Capital Structure on Financial Performance of Craft  
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## DECLARATION

This thesis is my original work and it has not been presented for a degree in any university.

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## **DEDICATION**

This thesis is dedicated to my wife, Naomi and children, Purity, Faith and Dorothy, for their love and patience throughout the study. To my parents for taking me to school and sparing their resources on my education. To my friends and colleagues for their unending encouragement and support.

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## ACRONYMS AND ABBREVIATIONS

<b>ANOVA</b>	Analysis Of Variance
<b>BC</b>	Bamburi Cement
<b>DF</b>	Debt Financing
<b>EAPCC</b>	East African Portland Cement Company
<b>EE</b>	External Equity
<b>EIB</b>	European Investment Bank
<b>EU</b>	European Union
<b>GDP</b>	Gross Domestic Product
<b>IEF</b>	Internal Equity Financing
<b>KZN</b>	KwaZulu-Natal
<b>LTD</b>	Long-Term Debt
<b>ME</b>	Micro Enterprises
<b>MFBs</b>	Micro Finance Banks
<b>MFI</b>	Micro Finance Institutions
<b>ME</b>	Micro Enterprises
<b>MSMEs</b>	Micro, Small and Medium Enterprises
<b>MSPWE</b>	Micro and Small Piped Water Enterprises
<b>MTT</b>	Market Timing Theory
<b>PERF</b>	Financial Performance of Craft Micro Enterprise
<b>POT</b>	Pecking Order Theory
<b>RE</b>	Retained Earning
<b>ROA</b>	Return on Assets
<b>ROCE</b>	Return On Capital Employed
<b>ROE</b>	Return on Equity
<b>ROI</b>	Return On Investment
<b>ROS</b>	Return on Sales
<b>SACCOS</b>	Savings and Credit Cooperative Society
<b>SBICs</b>	Small Business Investment Companies
<b>SBLCs</b>	Small Business Lending Companies
<b>SMEs</b>	Small and Medium-Sized Enterprises
<b>SMMEs</b>	Micro-, Small-, and Medium-size Enterprises

<b>SPSS</b>	Statistical Package for Social Sciences
<b>STD</b>	Short-Term Debt
<b>TD</b>	Total Debt
<b>TOT</b>	Trade Off Theory
<b>UNCTAD</b>	United Nations Conference on Trade and Development
<b>VCC</b>	Venture Capital Companies

## OPERATIONAL DEFINITION OF TERMS

- Capital Structure** refers to a firm's capital structure is a mix of debt and equity that a firm uses in financing its operations (Nyanamba et al., 2013).
- Craft** refers to the art of using hardwood species or soapstone to make carvings, ornaments or construction materials (Mutinda, 2014).
- Craft Microenterprises** These constitute quarry owners, miners, carvers, retailers, wholesalers (Obworiet al., 2012) and wood carving species (Muga, Githiomi & Chikamai, 2014).
- Debt financing** is a form of financing procured externally by the business which isto be repaid with interest at some future date (Torteska, 2012).
- Financial Performance** is the ability of the firm to meet both its long term and short term goals efficiently and effectively. It is measured using proxies such as profitability, return on asset, liquidity, solvency, and sales growth (Akinyi, 2014).
- Internal equity** financing is the form of business financing supplied by the owners of the business (Pandey, 2009).
- Micro enterprises** refers to those business enterprises which have employed between 1 and 9 employees (Ngugi, 2013).
- Retained Earnings** refers to part of a business' profit that is withheld by the business (Chen & Chen, 2010).
- Soapstone** refers to a kind of soft stone that can easily be curved to make decorations (Obwori et al., 2012)

## ABSTRACT

Craft industry contributes immensely to Kenyan economy. It is also a major source of income for not only micro enterprises but also small and medium enterprises. It has been observed that in spite of their vital contribution to the growth of the economy, the individual micro enterprises usually experience slow growth or not at all. It has also been observed that as a result of this inadequate capital, some of these craft micro enterprises have resulted to seeking additional capital from various sources so as to top up the deficit, hence resulting to various capital structures. The main objective of the study was to determine the influence of capital structure on financial performance of craft micro enterprises in Kenya. The specific objectives were to determine the influence of internal equity financing on financial performance of craft micro enterprises in Kenya, to establish the influence of debt financing on financial performance of craft micro enterprises in Kenya, to determine the influence of retained earnings on financial performance of craft micro enterprises in Kenya and to establish the moderating effect of level of education on the relationship between capital structure and financial performance of craft micro enterprises in Kenya. The study only covered the soapstone micro enterprises registered by Tabaka Town Council and the woodcarving micro enterprises registered by Wote Town Council. The study was a survey of soapstone micro enterprises in Tabaka Town and the woodcarving micro enterprises in Wamunyu Location. The target population for the study constituted all the 2334 craft micro enterprises. The sample frame constituted all the soapstone micro enterprises operating within Tabaka Town and all the woodcarving micro enterprises registered by Wote Town Council. The study used a sample of 330 craft micro enterprises drawn using stratified sampling technique. Data were gathered data using a semi-structured questionnaire and then analyzed by use of descriptive and inferential type of statistics. The ANOVA and multiple regression analysis were used to analyze the data. The results were summarized in tables, charts and graphs. The findings of the study revealed that, internal equity financing, debt financing and retained earnings have significant influence on the financial performance of craft microenterprises; and that level of education has a positive moderating influence on the relationship between capital structure and financial performance of craft microenterprises. The study recommended that the proprietors of the craft micro enterprises should be encouraged to use the three sources of finance because they have significant influence on the financial performance of craft microenterprises and that they should be sensitized on the importance of using retained earnings as a source of finance. The study will help to expose the effect of the various attributes of financing on financial performance of craft micro enterprises and also inform craft micro enterprise owners on the best financing to adopt so as to promote the financial performance. Those people who anticipate starting craft micro enterprises will also benefit from the study by knowing the best sources of finance from which to get capital so as to achieve faster financial performance. It will also help relevant financing institutions like commercial banks to know the effect that the loan they advance to craft micro enterprises have on the financial performance of craft micro enterprises.

## **CHAPTER ONE**

### **INTRODUCTION**

#### **1.1 Background of the Study**

##### **1.1.1 General Overview**

Lack of employment alternatives has pushed many people into self-employment activities which largely constitute the micro and small enterprises sector in any country (Stevenson, 2005). The terms micro, small, medium and large enterprises have been defined by different scholars in different ways (Lemuel, 2009). Different countries have come up with different definitions based on the number of employees, annual sales or amount of capital invested (Kushnir, Mirmulstein & Ramalho, 2010). Stevenson (2005) defines micro enterprise as a business entity having not more than ten employees including the owner, while a small enterprise is the one having eleven to fifty employees. Sessional Paper No.2 of 1992 and National Baseline Survey of 1999 cluster Kenyan enterprises in the following categories: Micro Enterprises are business enterprises having 1-9 employees, Small Enterprises constitute those enterprises which have employed between 10 and 49 employees; Medium Enterprises are those businesses with 50-99 employees; while Large Enterprises which has employed 100 or more employees (Ngugi, 2013). These sediments are shared by Kushnir et al. (2010) who define small, micro, medium and large enterprises as follows: Micro enterprises: 1-9 employees, small enterprises: 10-49 employees, and medium enterprises: 50-245 employees.

Kefale and Chinnan (2012) define micro enterprises as those business enterprises with a paid up capital of not exceeding Birr 20,000 (about 1176 dollars) and excluding high tech consultancy enterprises and other high-tech establishments, whereas small enterprises are those business enterprises with a paid up capital above Birr 20,000 and not exceeding Birr 500,000 (about 29,411 dollars), and excluding high-tech consultancy enterprises and other high-tech establishments. From the

above definitions, the study will adopt Kushnir et al. (2010) and Ngugi's (2013) definitions which identify micro enterprises as those with 1-9 employees.

There is no doubt that most of large size businesses start as a small business or at micro level (Ngugi, 2013). Micro, small and medium-sized enterprises (SMEs) are a major source of entrepreneurial skills, innovation and employment (Nyang'ori, 2010). Micro enterprises are characterized by uneducated but dynamic sole ownership with low technology, they are engaged in retail, arts and crafts, textiles, services (for example, Salons, tailoring) and have few links with donor sponsored providers (Lemuel, 2009). Small and micro enterprises are important in their contribution to growth of economy in Kenya as follows: promoting full productive and freely chosen employment, improving access to income earning opportunities, wealth creation leading to productive and sustainable employment quality, enhancing SMEs sustainable economic growth and ability to create change with flexibility, increase domestic savings and investment thus balancing regions and local development (Memba, 2011). Ekanem (2006) summarized various importance of SMEs, namely; ensuring rapid development, increased utilization of local resources and provision of a training ground for indigenous managers and semi-skilled workers, reduction of the rural-urban drift, development of indigenous technology and raising the living standard of rural dwellers, among others.

Micro enterprises together with small and medium enterprises contribute immensely to the economy of most countries in the world (Chimuneka & Rungani, 2011). For instance, Daskalakis, Jarvis and Schizars (2013) observed that micro and small enterprises constituted 99.6 per cent of the total number of firms operating in Greece. In India, the MSME sector is responsible for about 40 percent of the exports and 45 per cent of the total manufacturing output of the country regardless of the fact that they are constrained by untimely access to finance (Biswas, 2014). In South Africa, SM 74% of South Africans active in the economy are employed by SMMEs (Chimucheka & Rungani, 2011). In the European economy, microenterprises are among the major driving forces since they are the main source of employment, inspire and promote the entrepreneurial and innovative spirit in the EU and thereby

are of key importance to greater competitiveness and higher employment (Samitowska, 2011).

Nasirembe (2007) indicated that in Kenya, the MSE sector employs around 2.3 million people and generates around 14% of the country's Gross Domestic Product (GDP). According to Kyalo (2013), female entrepreneurs run around forty eight percent of the micro-, small-, and medium-size enterprises that are currently operating in Kenya. Majority of these MSMEs normally operate in the informal sector in remote areas of the country. Nasirembe (2007) further indicates that, due to the scarce resources in Africa, the best way for countries to achieve sustainable development is by supporting these SMEs that operate in the rural areas because this is where majority of the African population resides. Levy and Powell (2005) supports this claim by stating that SMEs are flexible and innovative organizations that are able to respond quickly to customer and market demands. In a recent study, Morone and Testa (2008) found out that on average, young firms are more likely to experience positive growth; moreover, growth in turnover is positively associated with firms' size, process innovation, product innovation and organizational changes. Carpenter and Petersen (2002) as cited in Wanambisi (2013) argue that firms whose financial needs exceed their internal resources may be constrained to pursue potential opportunities for growth. The insufficient internally generated liquidity is therefore one of the factors which are frequently cited as the causes of micro and small business failure in developing economies.

Haltiwanger, Jarmin and Miranda (2010) found out that in the United States of America, Startups and surviving young businesses are critical for job creation and contribute disproportionately to net growth. The study also indicates that SMEs contribute more to employment in low-income countries than higher-income countries and they also generate the most new jobs across country income groups.

A study by Mateev and Anastasov (2010) noted that although growth in manufacturing and service SMEs in transition economies is well explained by the traditional firm characteristics of size and age, there is no empirical evidence concerning what other specific factors may be associated with SME growth and

performance in these countries in Central and Eastern Europe. Heshmati (2001) cited in Mateev and Anastasov (2010) found a positive correlation between indebtedness positively affects sales growth using data on Swedish micro and small firms. On the other hand, Elston (2002) cited in Mateev and Anastasov (2010) developed sufficient reasons to believe that cash flow has an positively influences the growth of firms that are listed in the Neuer Market of Germany, even when controlling for firm size and age. Yongqiang, Armstrong and Clarke (2012) on seeking an instrument variable model of the impact of financing decisions on performance of small businesses in Australia found enough evidence to prove that the impact of equity financing on firm performance was less apparent in micro-enterprises than in medium-sized enterprises.

Babajide (2012) reiterated that it is very difficult for the small business enterprises in Nigeria to get credit from formal financial institutions such as commercial banks and this was attributed to their inability to meet the laid down requirements that need to be met before they qualify for the loans. Due to this problem, many of the SMEs made resulted in soliciting funds from informal sources of finance which have established themselves to fill the gap, usually based on informal social networks. The study realized that there was need for banks in Nigeria to have a recapitalization of the Microfinance banks so as to enhance their capacity to support small business growth and expansion. Evbuomwan, Ikpi, Okoruwa and Akinyosoye's (2012) study on preferences of micro, small and medium scale enterprises to financial products in Nigeria revealed that regardless of the immense contributions of micro enterprises (MEs) to economic growth and development not only in the developing but also in the developed world, they still face immense challenge of limited access of the investors to long term credit.

Onakoya, Fasanya and Abdulrahman (2013) found out that that loan to small scale entrepreneurs have a positive impact on the economic performance while interest rate has a negative impact on economic growth in Nigeria. Agyapong (2010) observed that micro enterprises in Ghana play key role in the economic wellbeing of developing countries by contributing to jobs through innovations and creativity as well as aiding human resources development. The study also adds that micro



enterprises contribute to tax, export and import revenues, facilitate the distribution of goods, contribute to human resource development and are the cradle of innovations and entrepreneurship. This claim is supported by Mensah (2004) who documents that in Ghana, 90% of firms registered are MEs and that the Ghanaian private sector, which is dominated by MSMEs, consists of approximately 80,000 registered limited companies and 220,000 registered partnerships. The immediate and the long run effect is that they improve the levels of income and ultimately contributing to poverty alleviation. Kefale and Chinnan (2012) observed that shortage of working capital and working space are the major problems facing micro enterprises in Ethiopia and that employment growth in small and micro enterprises were low.

Policy makers in Kenya expect micro and small enterprises to provide the bulk of new jobs created in the economy yet these enterprises face significant credit constraints (Moyi, 2013). A study by Akanji (2006) reiterated that despite the crucial role of women entrepreneurs in the economic development of their families and countries, they have low business performance compared to their male counterparts. This claim is seconded by Ekpe, Mat and Razak (2010) who observed that most women entrepreneurs, especially in developing countries, do not have easy access to microfinance factors for their entrepreneurial activity and as such have low business performance than their men counterparts, whereas the rate of their participation in the informal sector of the economy is higher than males.

A study by Kavinda, Maganjo and Kithae (2013) on the impact of entrepreneurship training on performance of Micro and small enterprises (MSEs) in Kenya revealed that entrepreneurship training has a substantial impact on performance of entrepreneurs. This is in support of Ngugi's (2013) study which found out that intellectual capital components (managerial skills, entrepreneurial skills, innovativeness, structural capital, and customer capital) have a great positive influence on the growth of enterprises in Kenya. Njenga (2012) found out that asset tangibility, firm's profitability, size of the firm, firm's growth opportunities and finally liquidity of a firm's assets, economic growth and corporate tax rate are the major factors affecting the capital structure of listed firms in Kenya.

Obwori, Iravo, Munene and Kaburi's (2012) study on the effects of funding constraints in growth of small scale enterprises in soapstone industry in Kenya, found out that, collateral, bank accounts and high interest rates for loans inhibit the entrepreneurs' access to funds. The study further cited lack of adequate skills among some of the entrepreneurs in the industry, lack of market access and inefficient methods of production which lead to waste of raw materials, as some of the challenges facing soapstone enterprises. The findings of the study by Mwangi and Birundu (2015) on the effect of capital structure on the financial performance of Small and Medium Enterprises in Thika Sub-County, Kenya concluded that there was no significant effect of capital structure, asset turnover and asset tangibility on the financial performance of SMEs.

A firm's capital structure refers to the mix of its financial resources available for carrying on the business (Ngambi & Wake, 2015). It is considered important corporate financial management context and is mainly related to the establishment of an ideal debt policy (Maina & Kondongo, 2013). Friend (2008) define capital structure of a firm as the mix of equity and debt which a firm deems as appropriate to enhance its operations. This mix can have an effect on the overall cost of capital of a business and hence its value. The study by Deakins, Whittamand Wyper (2010) classified sources of finance for enterprises into two broad categories: internal and external. According to the study, internal source of finance comprises of retained earnings, personal finance like savings, credit cards, internal equity, sale of assets or inventories, working capital, and funds from family and friends (Titman, Keown & Martin, 2011). Krénusz (2005) divided the factors determining capital structure (determinants) into two large groups. The study named as macro factors those regional- or country-specific characteristics, on which companies have no effect. These factors influence outwardly (exogenously) the financing decisions of firms. The micro factors (endogenous factors) are the speciality of the companies, which affect capital structure policy directly.

Different ways of financing determine the enterprise's capital structure and its changes (Duan et al., 2012). A firm can issue a large amount of debt or a large amount of equity; hence it's important for a firm to deploy the appropriate mix of

debt and equity that can maximize its overall market value (Maina & Kodongo, 2013). In equity capital, the investors are partners in a company or firm while debt capital involves acquisition of extra capital from sources outside the firm, like creditors and loans (Nyanamba, Nyangweso & Omari, 2013).

Debt and equity are the two major classes of financing in a business. Debt holders exert lesser control over the company and earn a fixed rate of return and are protected by contractual obligations (Ngambi & Wake, 2015). Firms choose between debt and equity as financing resources based on firm-specific factors namely, profitability, firm size, tangibility, among others; as well as macroeconomic factors like inflation rate, interest rate, economic growth (Brendea, 2012). A company's choice of capital structure determines the allocation of its operating cash flow each period between debt holders and shareholders (Chowdhury & Chowdhury, 2010). The firm's capital structure can be made optimum through among other things; minimizing the use of debt as a means of financing SMEs since often these debts are acquired by the firm at a cost in the form of interest paid on the debt. As much as the use of debt may increase the return on equity funds, but it always increases financial risk as well (Nyanamba et al., 2013). Duan et al. (2012) observed that with the rapid development of modern market economy, in order to safeguard the comprehensive competitiveness, enterprises adjust their capital structure based on the external and internal environment.

Whereas Romano et al. (2000) cited in Nawi (2015) categorize capital structure into four main parts: capital and retained profits, family loans, debt, and equity; Gibson (2002) categorizes it into five types, namely owner equity, related person debt, trade credit, bank loan, and other debt or equity such as credit cards, venture capital, and government loans. The capital structure determines structures of long-term debts and equity capital of a firm.

The growth of the SMEs is viewed as an accumulation of assets and it is usually measured as a single phenomenon especially financial or employee growth (Ngugi, 2013). Sekyewa (2009) measured the level of business performance in terms of perceived changes in an SME's physical asset base, number of employees, size of

clientele, and total revenue realized. Both Ngugi (2013) and Gateya (2012) agree on increase in sales, employees growth, return on assets and return on equity as the best measure of a business' growth. The growth of Micro enterprises boosts employment more than the growth of large firms because Micro enterprises are more labor intensive (Agyapong, 2010). Therefore the study will also measure the growth of soapstone micro enterprises in terms of the above variables.

### **1.1.2 Craft Enterprises**

Makhitha (2015) defined craft as the creation and production of a broad range of utilitarian and decorative items made on a small scale using natural or synthetic materials with hand processes being a substantial part of the value added content. Rogerson (2010) define craft as a product that is at least 80% handmade from different materials which can include clay, natural fibre, beads, recyclables and textiles. Foltys, Dębicka-Ozorkiewicz, Królczyk and Hiadlovský (2015) defined craft enterprises as a unique form of small and medium-sized enterprise (SME) which represent an combination between the manufacture of products and the fulfillment of artistic vision.

Micro and craft enterprises constitute not only the greatest percentage of SMEs in Europe, but are also the main employment in the European Union, being active in many rather traditional professions that are indispensable for the success and wellbeing of both urban and rural dwellers (Makhitha, 2015). According to Rogerson (2010), crafts involves making curios, home ware, gifts, novelties, fashion wear and “one of a kind” collectables. A study by Hawkins Jr. (2007) classified craft products into “traditional crafts” which refer to certain crafts have been pursued for many years in specific geographical localities; “handicrafts” which refers to the other forms of craft that are as a result of modern interventions. Ogunduyile, Kayode and Ojo (2008) asserted that apart from mass producing works for sale through trade fairs, galleries, craft shops, and other retail outlets at minimal rate, designer, a professional artist, or those working as craftsperson may occasionally have the opportunity of working on commission.

Craft industry is regarded as the as an important for employment creation, sustainable development and for economic growth. Besides, it is also a survivalist sector (UN, 2010). It is regarded as one of the outstanding industries due to its ability not only to accommodate a larger sales force compared with the larger industry, but it can also give significant contribution to a country's GDP (Tambunan, 2011). This industry is regarded as one of the oldest in Malaysia, having begun as early as 800 years ago (Manan & Mamat, 2011). The findings of Manan and Jan (2010) witnessed that enterprises in the craft industry are normally small in size and well spread across a country. The study further points out that craft industry's products play a vital part in boosting the performance of tourism industry. Further still, they are not only a source of employment but also a source of business opportunities (Manan & Mamat, 2011). In Kenya, the craft industry produce variety of craft-based products like handicrafts, textiles, bed sheets, garments, paintings, batik and curtains, ornaments, pottery, among others.

A research by Makhitha (2017) cited several challenges facing craft enterprises in their study on the challenges affecting small craft producer business growth and survival in South Africa. These include; lack understanding of the market needs, lack skills in product design, distribution and organization management, limited awareness of the lifestyles and product likings of potential customers, competition from the low-priced, machine-made products from other countries, for instance china. Additionally, a report by the Urban-Econ Tourism (2010) stated that large retailers pose another challenges to the entrepreneurs in the sense that former have market power that consents them to return any unsold goods during a given period, and this discourages some craft producers from selling to craft retailers.

Rogerson (2010) on the constraints and policy challenges among the craft enterprise South Africa, warned that, despite the rise of new research initiatives, South African research on craft enterprise development rests undeveloped especially as compared to rich detailed investigations that exist for understanding rural handicraft firms in other parts of the world.

Dumbu and Chadamoyo (2012) on the managerial deficiencies in the SMEs in the craft industry in Zimbabwe had reasons to believe that almost every economy that has reached major economic growth had a focused their attention to promoting SMEs. However, the study lamented that most of the SMEs didn't practice the basic management functions of planning, organizing, leading and controlling are not practiced, and that financial management and other key management areas are weak in SMEs in the craft industry.

Wherry (2006) regarded tourism related handicraft business as an instrument that can help to balance economic growth and distribution, poverty reduction as well as minimize rural to urban migration in Malaysia. It is in view of this that the Malaysian government resulted in formal support handiworks sector by raising competent businesspersons and generate engagement at the grassroots level and endorsing the use of local raw materials and community involvement in craft industry.

Studies indicate that, during pre-history times, the soapstone was used by Tabaka residents to mainly for artistic, ornamental and functional products as witnessed from the prehistoric remains or artifacts observed on rocks in places like Muma, Sameta, Gotichaki, Nyatike Nyabigena, (Obwori, Iravo, Munene & Kaburi, 2012). The study further indicates that, since the late 19th century, Tabaka residents have been using soapstone to produce carvings which they sell either locally, nationally or even internationally. The kind of carvings made from this stone ranges from items like candle holders, tiles, carvings for animals and maps, name tags and ornaments, among others. This means that the soapstone has been a source of livelihood to the community for a long time.

Carving in Wamunyu location has equally been an activity embraced by the residents since time immemorial. This led to them forming an organized society known as Wamunyu Woodcarving Cooperative Society, which was officially registered in 1965. This society came up with a large showroom that acts as their marketing base. This room is frequently visited by retailers, both and middlemen both locals and international, who visit to purchase either finished or semi-finished carvings. With this kind of organization, the members are able to sells around 5500 pieces per

month. The findings of Mutinda (2014) identified Wamunyu has the greatest producer of woodcarvers in Kenya, and this was attributed to the availability of the wood species that are used for carving.

### **1.1.3 Capital Structure**

Mateev and Ivanov (2011) sought to establish the link between SME's characteristics and their capital structure. Using a panel data analysis of 3175 SMEs drawn from seven Central and Eastern Europe countries during the period 2001–2005, the study discovered that, the SMEs uphold the Pecking Order theory in their decision to get more capital. Upon controlling for other firm specific characteristics such as sales growth, future growth opportunities, liquidity, size and assets structure, cash flow was found to be having a strong influence on firm leverage, although the determinants of firm leverage may be considerably different depending on firms' age and size. Interestingly, it was observed that cash flow portrays a negative significant relationship only for medium-sized firms but not in large firms because the latter have sufficient internal funds hence they do not see the need to use external funding.

Bhaird and Lucey (2010) investigated the determinants of the capital structure among the Irish SMEs and the findings revealed that ownership structure, age, level of intangible activity, size and the provision of collateral were all significant in influencing the capital structure in SMEs, and that their influence was similar across industry sectors. Palacín-Sánchez, Ramírez-Herrera and Di Pietro (2013) examined whether the capital structure of SMEs and its firm-factor determinants namely, asset structure, size profit, age and growth, differ across regions in Spain in the period 2004–2007. The findings of the study acknowledged that impact of firm-factor determinants on leverage vary from one region to another within the country under study.

Saarani and Shahadan (2013) wanted to determine the influence of capital structure on the ability and success of a Malaysian SMEs and the results revealed that size was influential only when debt is considered as long term or short term separately. The study singled out liquidity, asset tangibility and profitability as the main factors that

influenced capital structure determinants among Malaysian SMEs while growth and size had insignificant role to play in influencing long term debt. It was also observed that taxation had no effect on capital structure decision.

Napompech (2013) on investigating the determinants of capital structure of small Firms in Thailand noted that although small firms played a vital role to the growth of the national economy, the experienced serious difficulty accessing capital for future development. The study further revealed that small firms use mostly short-term debt to finance their operations and that firm age and growth positively related to short-term debt, whereas, profitability is negatively related. It was also evident from the study whereas age and asset structure were positively associated with long-term debt, firm size and profitability and size are negatively associated with long-term debt.

Kumar (2014) did an analysis of the capital structure pattern of small and medium enterprises India and the results showed that the long term funds constituted the greater portion of total funds when compared to short term funds employed, and that firms do not utilize their debt to the best advantage of the shareholders as revealed by a higher interest coverage ratio. It was also pointed out that optimal capital structure increases the shareholder's wealth with best combination of debt and equity mix thereby minimizing the cost of capital.

Krasauskaite and Hirth (2011) analyzed the leverage decisions of micro, small and medium-sized enterprises in the Baltic countries, with regards to the determinants of long-term debt financing. To achieve this, the study classified the enterprises as micro, small and medium-sized enterprises so as to test whether factors that affect capital structure are the same for the three classes of enterprises. The findings from the study indicated that firm size has a negative significant relationship on leverage. Further analysis revealed that micro enterprises were less levered than small or medium-sized firms, and that however, when only firms with positive long-term debt amounts are considered, micro firms, on average, are more indebted than small firms, and small firms, on average, have higher leverage ratios than medium-sized enterprises.



Do Carmo Silva (2015) analyzed the impact of capital structure on startups' growth in Portugal, and the findings proofed that whereas liquidity and size have a positive impact on sales growth, debt-to-equity ratio and the age of startups exhibited a negative impact on sales' growth.

Malayah (2012) investigated capital structure of SMEs in Monrovia, Liberia and it was realized that whereas profitability had a negative relationship with leverage, asset structure and age had a positive relationship. In an effort to explain the capital structure of SMEs in sub-Saharan Africa, Abor and Biekpe (2009) observed that firm's age, asset structure, size, growth and profitability all play an important role in determining the capital structure of Ghanaian SMEs. The study cited short-term debt as the major source of financing for the SMEs in Ghana.

Omondi (2013) assessed the impact of microfinance on the growth of small Businesses in Kisumu municipality, and the findings revealed that availability and accessibility to credit from micro-finance institutions positively influences the growth of the SMEs. The study further confirmed that there exists a positive relationship training program offered to the micro entrepreneurs, financial, business idea generation services and advisory services and growth of the SMEs.

Adankanhounde (2017) wanted to know the various forms of loyalty which have been adopted by the customers of craft small businesses in Benin, and the findings revealed that very small enterprises do not adopt normative fidelity. It was also evident from the study that behavioral fidelity and attitudinal and affective fidelity were the only types of fidelity which were adopted by the craft enterprises under study.

Monge (2016) analyzed the impact of microcredit in the performance of SMEs in Tanzania, with special focus on Temeke Municipality. The main aims of the study were to assess the influence of MFIs training on the financial performance of SMEs, to assess the impact of MFIs loan in the business expansion of SMEs, to establish whether MFIs offers a better environment for SMEs to improve their productivity, and to assess quality of services offered by SMEs after getting the MFI loan. The results of the study reported that although only a small percentage of entrepreneurs

managed to receive the amount of loan they requested for, most of the SMEs benefitted from the MFIs loans in both economic and social well-being of entrepreneurs. The study further observed that there was a positive link between loan advanced to the SMEs and the financial credibility, market share, sales revenue, number of employment, decreased liabilities and net profits of the SMEs.

Chirchir (2017) wanted to know the financial factors that influence financial accessibility by small and medium enterprises in Eldama Ravine Sub-County, Kenya. The study purposed to expose the influence of interest rates, cost of credit, business risk and credit rationing on financial accessibility. The findings from the study revealed that high transaction costs discourage in the sense that they increase the cost of borrowing, and that the size of an enterprise greatly influences the ease of lending by financial institution. This claim is supported by Gichuki et al. (2014) whose study on the challenges facing MSEs in accessing credit facilities in Kangemi Harambee Market in Kenya, developed sufficient reasons to believe that high repayment cost of loans greatly discouraged access to credit facilities by micro and small enterprises.

Romantsev, Efanov, Moiseev, Bychkova, Karpova and Tidemann (2016) researched on the theory and practice of development Craft training in Russia, and observed that craft activities characterize a significant segment of the Russian economy, as evident from the fact that there were several craft industries which have been established and deal with processing of raw materials and public services. According to the study, there are appropriate supporting infrastructure legal framework, supporting infrastructure and craft training system that have been put forth by various countries which have citizen practicing craft enterprises. The study further identifies craft activities to include components of at least three occupational areas, namely; production technology sphere, skilled worker occupations and business management processes.

## **1.2 Statement of the Problem**

Craft industry contributes to Kenyan economy through improved infrastructure, employment, tax revenue to the government and foreign exchange. Besides, it is a

major source of income for not only micro enterprises but also small and medium enterprises and also the local community (Obwori et al., 2012). However, studies have indicated that in spite of the important role they play in the growth of the economy, they have been experiencing financial difficulty. The fact that harvesting of the soapstone is done manually using the traditional tools (shovels and pick axes), which waste time and leads to low productivity (Obwori et al, 2012) is evident to the fact that the craft micro enterprises lack capital to modernize their activities. The over-exploitation of wood carving species leading to some of them getting almost extinct has further limited wood carving activity (Muga, Githiomi & Chikamai, 2014). It has also been observed that many individual micro enterprises grow slowly or not at all – in some cases, due to a conscious decision on the part of the business owner (Nichter & Goldmark, 2009). Worse still, some have closed down soon after their start-up. Inadequate capital has been perceived as one of the major reasons why there is poor performance among micro enterprises in various parts of the world (Obwori et al., 2012). It has also been observed that as a result of this inadequate capital, some of these craft micro enterprises have resulted to seeking additional capital from various sources so as to top up the deficit, hence resulting to various capital structures. However, there are scanty documented studies (known to the researcher) that have been done on such enterprises to ascertain which capital structure yields most returns, from that adopted. Besides, some variables have been ignored by other researchers in their study on the effects of capital structure on growth of micro enterprises. There are only few study that has been done in this area, for instance, Obwori et al.'s (2012) study which concentrated on the effect of funding constraints on the growth of small scale enterprises in soapstone industry of Kenya. However, the study did not address the variables of capital structure exhaustively since it only concentrated on funding on a general perspective. Besides, the study used descriptive statistics (mean and percentages) only to arrive at conclusions on the study. It is for this reason that this study was done that is adopting more superior tools for data analysis so as to fill the gap.

### **1.3 Objectives of the Study**

The main objective of the study was to determine the influence of capital structure on financial performance of craft micro enterprises in Kenya. The specific objectives of the study were:

- i. To determine the influence of internal equity financing on financial performance of craft micro enterprises in Kenya
- ii. To establish the influence of debt financing on financial performance of craft micro enterprises in Kenya
- iii. To determine the influence of retained earnings on financial performance of craft micro enterprises in Kenya
- iv. To establish the moderating influence of level of education on the relationship between capital structure and financial performance of craft micro enterprises in Kenya

### **1.4 Hypotheses of the Study**

The study was guided by the following hypotheses:

- H<sub>01</sub>:** Internal equity financing has no significant influence on financial performance of craft micro enterprises in Kenya
- H<sub>02</sub>:** Debt financing has no significant influence on the financial performance of craft micro enterprises in Kenya
- H<sub>03</sub>:** Retained earnings have no significant influence on the financial performance of craft micro enterprises in Kenya
- H<sub>04</sub>:** Level of education has no significant moderating influence on the relationship between capital structure and financial performance of craft micro enterprises in Kenya

### **1.5 Scope of the Study**

The study only covered the Soapstone micro enterprises which are registered by Tabaka Town Council in Kisii County and the woodcarving micro enterprises of Wamunyu Location which are registered by Mwala Town Council, Machakos County. The study was a survey of soapstone micro enterprises in Tabaka Town and Wamunyu Location, whose findings was used to generalize on the craft micro enterprises in Kenya.

### **1.6 Significance of the Study**

Carving is one of the most lucrative industries in Kenya. It is highly associated with the tourism industry and enjoys large volume of export market worldwide (Muga et al., 2014). Craft micro enterprises contribute so much towards the development of a country's economy, besides improving the entrepreneur's economic status (Obwori et al., 2012). However, there is little research that has explicitly addressed how the various component of financing affects the financial performance of craft micro enterprises. Therefore the study will help to expose the effect of the various attributes of capital structure with respect to boosting the financial performance of craft micro enterprises. The findings of the study will also inform craft micro enterprise owners on the best form of capital structure to adopt so as to promote the financial performance of their micro enterprises. Those people who anticipate starting craft micro enterprises will also benefit from the study by knowing the best source(s) of finance from which to get capital so as to achieve faster financial performance of their business. The study will also help relevant financing institutions like commercial banks to know the effect that loan advanced to craft micro enterprises (if any) have on the financial performance of craft micro enterprises. Above all, the study will be instrumental to future researchers by forming a basis for their research.

### **1.7 Limitations of the Study**

The findings of the study may not truly represent the effects of capital structure of all the craft micro enterprises in the other parts of the country due to the diverse socio-economic backgrounds of the different tribes. Besides, it is also not easy to access all

the craft micro enterprises since some of them operate their craft activities from their homes so as to evade taxation.

### **1.8 Delimitations of the Study**

The study tried to involve all the sub sectors involved in the craft industry so that all the various types of entrepreneurs in this industry are well represented in the sample. The study also incorporated the two major regions in which craft industry has taken root. By doing so, it was assumed that a true picture of the influence of the capital structure with regard to craft micro enterprises would be achieved.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.1 Introduction**

This chapter presents the empirical and theoretical literature related to the capital structure of micro enterprises, the various forms of financing as used in the objectives and the conceptual literature of the study. The chapter also highlights the various published literature that relates to the study being undertaken.

#### **2.2 Theoretical Literature**

The capital structure of a firm could be explained, in general terms, theories. These include the Market Timing Theory (MTT), the Static Trade-Off Theory (TOT) and Pecking Order Theories (POT) (Maina & Kondongo, 2013).

##### **2.2.1 The Static Trade-off Theory**

The Static trade-off theory (TOT) was developed by Myers (1984). The TOT assumes that there are optimal capital structures which can be obtained by trading off the benefits and cost of debt and equity (Chen, 2013). Under the tradeoff theory of capital structure, firms determine their preferred leverage ratio by calculating the tax advantages, costs of financial distress, mispricing, and incentive effects of debt versus equity (Faulkender & Petersen, 2006). In other words, a firm is viewed as setting a target debt to value ratio and gradually moving towards it, just the same way a firm adjusts dividends to move towards a target payout ratio (Maina & Muturi, 2013). Under this framework, optimal capital structure is reached when tax advantage to borrowing (tax shield) is balanced, at the margin, by cost of financial distress. One of the benefits of the use of debt is the advantage of a debt tax shield which is associated with it. However, the cost of potential financial distress poses a threat especially when the firm relies on too much debt.

According to this theory, investors are risk-neutral and face a progressive tax rate on end-of-period wealth from bonds. Dividends and capital gains are taxed at a single

constant rate. Risk neutrality induces the investor to invest into whichever security offers the better expected after-tax deal. The theory goes on to say that since the firm faces a constant marginal tax rate on end-of-period wealth. The firm can deduct both interest and principle payments, but the investor must pay taxes as these payments are received. Non-debt tax shields exist but they cannot be arbitrated across firms or across states of nature. This means that, a micro enterprise's choice of internal equity or external equity depends on which one of the two yields more benefits. If there are more incentives on debt like tax advantage and less cost of financial distress, then a micro enterprise will opt for external equity; but if the incentives on debt are less, then the micro enterprise will opt for internal financing. The TOT has been applied in a number of studies on capital structure. Berger and Bonaccorsi di Patti (2006) supported the TOT by stipulating that more efficient firms are more likely to earn a higher return for a given capital structure, and that higher returns can act as a buffer against portfolio risk so that more efficient firms are in a better position to substitute equity for debt in their capital structure. Hence, more efficient firms choose higher leverage ratios because higher efficiency is expected to lower the costs of bankruptcy and financial distress.

Maina and Muturi's (2013) study tested and found favour on the static trade off framework by stating that increasing the debt to equity ratio in the Kenyan banking industry beyond the optimum level will negatively impact on the ROA. Mohammed (2012) also noted that the relationship between the total debt ratio changes and outstanding leverage levels, asset tangibility, agency costs and the future growth prospects of companies in Nigeria are consistent with the predictions of the trade-off theories. Besides, Tahvanainen (2003) tested and found support for the TOT by noting that high-risk companies have low leverage levels.

However, a study by Huang and Ritter (2004) found out that profitable firms are less likely to issue debt, contrary to the static tradeoff prediction that these firms should issue debt to reduce agency costs and tax liabilities. A study by Li, Ong and Ooi's (2007) study also contradicted TOT by realizing that higher stock return variance has negative effect on the probability of a debt issue, but the effect is not significant. Further still, a research by Brealey, Myers and Allen (2006) conflicted with the TOT



in the sense that it failed to explain why the most profitable firms have very low leverage.

It is also relevant to the study in the sense that it will enable the study to know whether the craft micro enterprises determine their preferred leverage ratio by calculating the tax advantages, costs of financial distress, mispricing, and incentive effects of debt versus equity. This theory was found to be relevant in study since it was used in previous studies on capital structure, for instance, Nyanamba et al. (2013), Faulkender and Petersen (2006), Maina and Muturi (2013) and Li et al. (2007).

### **2.2.2 The Market Timing Theory**

The market timing theory (MTT) was introduced by Baker and Wurgler (2002). The theory states that firms prefer external equity when the cost of equity is low, and prefer debt financing when the cost of external equity is high (Huang & Ritter, 2004). According to this theory, capital structure is a consequence of managers trying to time equity markets by issuing shares at high market prices and repurchasing them or issuing debt at low market prices (Salminen, 2013). The intention of market timing is to exploit temporary fluctuations in the cost of equity relative to the cost of other forms of capital (Baker & Wugler, 2002). The study further claims that in capital markets that are inefficient or segmented, the market timing benefits ongoing shareholders at the expense of entering and exiting ones. According to this study, managers have incentives to time the market if they think it is possible and they care more about ongoing shareholders.

According to the market timing theory, there is no optimal capital structure, so market timing financing decisions just accumulate over time into capital structure outcome. There are two versions of equity market timing that would be behind these findings. The first version is the dynamic version of Myers and Majluf (1984) with rational managers and investors which claims that the extent of adverse selection varies across firms or across time and is inversely related to the market to book ratio; while the second version is that managers think investors are irrational and raise

equity when the cost of equity is unusually low. Managers issue equity when they believe that its cost is irrationally low and repurchase the equity when they believe its cost is irrationally high. The evidence that supports the mispricing version comes from the low long-run returns following equity issues and high long-run returns following repurchase. The magnitudes of these effects suggest that managers are, on average, successful at market timing.

However, Chang, Chang, Sudipto and Gilles (2006) observed that information asymmetry affects a firm's incentives to time the market. In particular, the study showed that firms with low information asymmetries (the ones with greater analyst coverage) have lower incentives to time the market. Firms followed by fewer analysts make infrequent but larger issues of equity. Huang and Ritter (2004) distinguish between the Pecking Order Theory (POT) and the MTT by stating that the POT relies on semi-strong market efficiencies while the MTT makes no such a prediction. Baker and Wurgler (2002) found favour for the MTT by opining that a firm's capital structure is mostly influenced by the historical securities pricing. That is, companies with low leverage tend to be those that raise funds when their valuations were high. Baker and Wurgler (2002) provide evidence that equity market timing has a persistent effect on the capital structure of the firm. The study defined a market timing measure, which is a weighted average of external capital needs over the past few years, where the weights used are market to book values of the firm. Having found out that leverage changes are strongly and positively related to their market timing measure, the study concluded that capital structure of a firm is the cumulative outcome of past attempts to time the equity market. In the micro enterprise setting, it means that, firms go for external financing when the cost of borrowing is less (that is, when there are low interest rates), but will restrict themselves to internal financing if the interest rates are high. This is because firms won't prefer paying more on interest rates when they can get the same amount of capital from internal sources like retained earnings and profits.

The MTT was of paramount importance to this study in judging whether or not craft micro enterprises prefer external equity when the cost of equity is low (in the form of interest rates), and prefer debt financing when the cost of external equity is high. It is

perceived that if the interest rates are low, the craft micro enterprises will be enticed to seek funds from external sources in the form of loans from banks and other financial institutions, and if interests escalate, then they will result in seeking capital from the internal sources. This theory had also been found applicable in previous related studies like Huang and Ritter (2004) and Chang et al. (2006)

### **2.2.3 The Pecking Order Theory**

The Pecking Order Theory (POT) was developed by Myers and Majluf in 1984 (Salminen, 2013). The POT suggests that firms will initially rely on internally generated funds, and then they will turn to debt if additional funds are needed and finally they will issue equity to cover any remaining (Ahmad, Abdullah & Roslan, 2012). The pecking order theory assumes that there is no target capital structure. This theory argues that firms follow a certain hierarchical fashion in financing their operations in the sense that they initially use internally generated funds in the form of retained earnings, followed by debt, and finally external funding (Chepkemoi, 2013; Mateev, Poutziouris & Ivanov 2013). Chepkemoi (2013) further proclaims that preference is a reflection of the relative cost of the available sources of funds, due to the problem of information asymmetries between the firm and potential finance providers.

The pecking order theory predicts a negative relationship between debt ratio and profitability, because firms use first of all, as financing sources, the available internal funds and debt as a last resort (Brendea, 2012). According to the pecking order hypothesis, firms that are profitable and therefore generate high earnings are expected to use less debt capital than those who do not generate high earnings (Ahmad et al., 2012). This is because funds used from profits do not dilute ownership. Besides, the funds obtained from debt attract interest which is an extra burden to the firm. According to the Pecking Order theory, there is no optimal debt-equity mix because there are two kinds of equity, retained earnings at the top of the pecking order and the issue of new shares at the bottom (Myers, 1984). The Pecking order Theory further stipulates that optimal capital structure is reached when tax advantage to borrowing (tax shield) is balanced, at the margin, by cost of financial

distress (Maina & Muturi, 2013). Myers (1984) summarizes the theory by stating that there is no optimal debt-equity mix because there are two kinds of equity, retained earnings at the top of the pecking order and the issue of new shares at the bottom.

Myers (1984) claims that asymmetric information and transaction costs overwhelm the forces that determine optimal leverage in the trade-off models. For this reason therefore, to minimize these financing costs, firms prefer to finance their investment first with internal cash flows. Only if there's residual financing need will firms use external capital in the following order; first safe debt, then risky debt and finally equity issues. So, contrary to the trade-off theory, the pecking order theory predicts no long run target capital structure (Maina & Kondongo, 2013). The POT does not recognize existence of an optimal debt-equity mix because there are two kinds of equity, retained earnings at the top of the pecking order and the issue of new shares at the bottom (Myers, 1984).

The POT is particularly applicable to firms that are small and privately held, precisely because the informational asymmetries are so large (Coleman, 2006), and this is because small, privately held firms do not publish annual reports hence their financial statements are not publicly available and for this reason, financial institutions have no way of knowing the financial condition of the firm. According to the study, this lack of information poses asymmetry problem leading to a higher level of risk, and subsequently higher cost of external capital.

Tahvanainen's (2003) study observed that the pecking order theory would only partially explain the financing behavior of small Biotech firms in Finland. Bayrakdaroğlu, Ege and Yazici (2013) found out that bigger companies tend to have higher debt ratios when compared to the small Companies, and that profitable Turkish Companies prefer less debt. This leads into the conclusion that TOT is less successful than the pecking order hypothesis in explaining the capital structure of the Turkish Companies, meaning that Turkish companies are following pecking-order hypothesis in their debt behaviors.

A study by Eriotis, Vasiliou and Ventoura-Neokosmidi (2007) indicated that firms with high liquidity tend to use less debt. This means that firms generally finance their

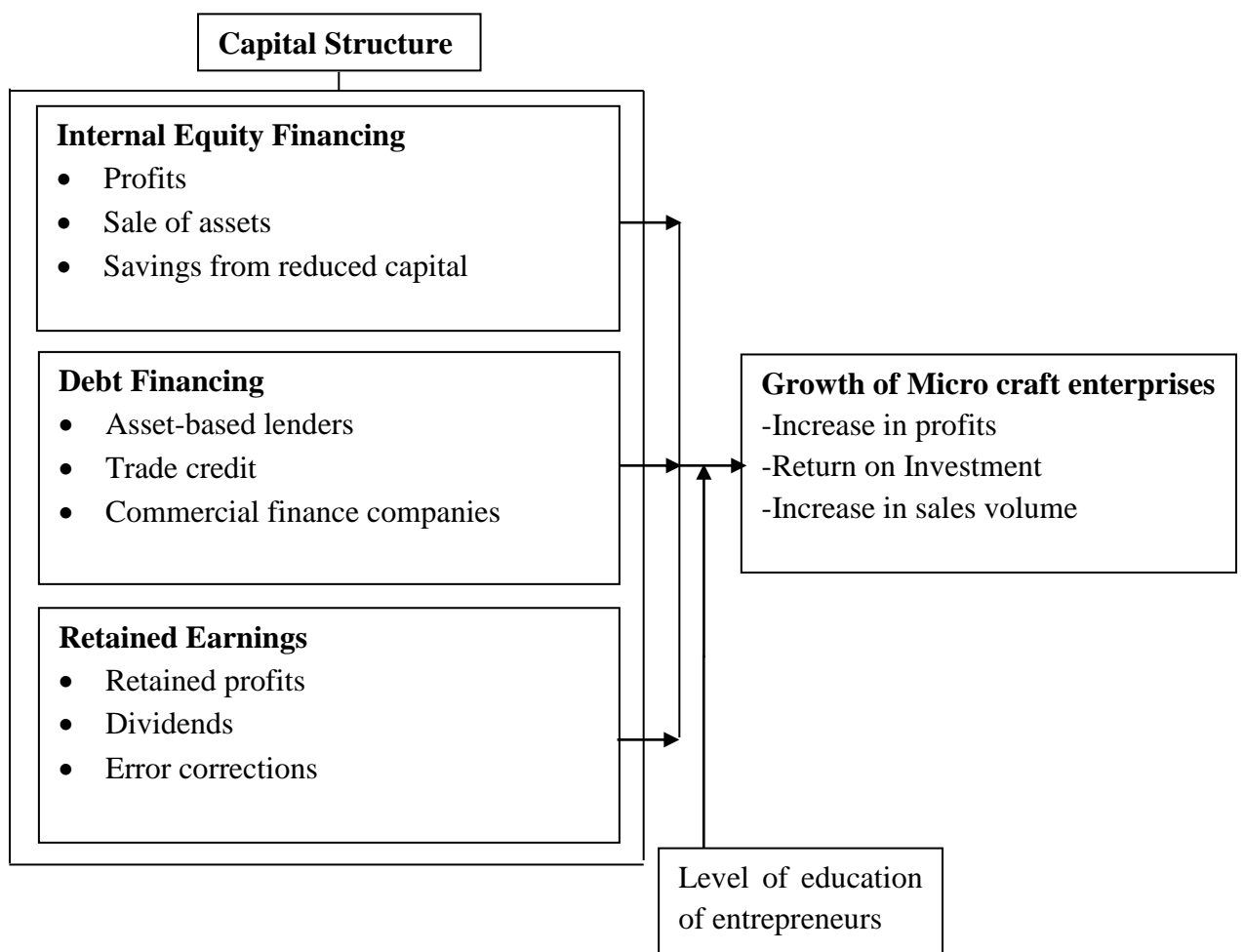
activities following the financing procedure implied by the pecking order theory. Firms with high liquidity maintain a relatively high amount of current assets, which means that they maintain high cash inflows, hence they also generate high cash inflows. As a consequence, they are able to use these inflows in order to finance their operating and financing activities. Thus, they do not use much debt capital in comparison with firms that are not so profitable because they prefer to use these funds rather than debt capital; this is in fact is in full support of the POT. Daskalakis and Psillaki (2008) argue that the pecking order theory can be easily applied in small firms because small firms borrow as their investment needs rather than an attempt to achieve an optimal capital structure.

This theory is relevant to this study because it will assist in determining whether or not craft micro enterprises exhaust internally generated funds before turning to debt financing. The theory implies that micro enterprise could opt to use internal financing (profits, sale of assets and savings from reduced capital) as a means of financing and will only result to debt finance (Commercial bank loans, funds from friends, family finance, bank overdraft, SACCOs and welfare groups, Development banks and supplier credit) after exhausting internal finances. This is because internal sources of finance are perceived to be cheaper compared to debt as means of financing. This theory has been found to be of help to previous studies on capital structure, for instance, Maina and Kondongo (2013), Tahvanainen (2003), Eriotis et al. (2007) and Daskalakis and Psillaki (2008).

### **2.3 Conceptual Framework**

Figure 2.1 shows the conceptual framework of the effects of capital structure on financial performance of micro enterprises. The independent variable was the capital structure which consisted of internal equity financing, debt financing and retained earnings; while the dependent variable was the financial performance of soapstone micro enterprises which constituted increase in profits, return on investment and increase in sales volume. It was hypothesized that when the firm results in optimal capital structure either by additional equity or by use of retained earnings, the firm will be able to undertake more business activities and this will lead to increase in

sales volume and this will result in more profits. This implies that there would be increase in financial performance witnessed of the firms. The moderating variable of this study was level of education. It was perceived that the level of education, to some extent, determines how efficient the independent variables (additional equity financing, debt financing or retained earnings) will influence the financial performance of micro enterprise in the sense that without proper education, someone may not be able to make proper judgment on when to solicit extra capital and from which source from the various source of financing.



**Independent Variable**

**Moderating Variable**

**Dependent Variable**

**Figure 2.1: Conceptual Framework**

## **2.4 Empirical Literature**

### **2.4.1 Financial Performance of Micro Enterprises**

Micro and small enterprises (MSEs) have become the focus of attention for the economic development, economic growth and job creation in the world (Wanambisi & Bwisa, 2013). Turyahebya (2013) defined financial performance as the ability of the MSEs to operate efficiently, survive, generate effective income and expand by observing environmental opportunities and threats. Several studies have used various measures to measure financial performance.

Moazzem (2013) noted an insignificant rise of share of SMEs in the GDP and attributed this to the limited role in catering the growing need with regard to supply, quality and standard. The study regretted that most MSMSEs rarely graduated to the next level from their existing micro, small and medium level. Worse still, the study lamented that financial performances of the MSMEs are not outstanding in terms of revenue earnings, machinery use, capital-labour ratio and growth of value added except labour-productivity in some instances. Kibet, Achesa and Omwono (2015) submitted that enterprises account more than one – half of the economic activities of the countries within the sub- region, and that, in Tanzania, they contribute about 12% and 34% of rural and urban employment activities.

Abay, Tessema and Gebreegziabher (2014) recognized the importance of micro and small enterprises by claiming that they are an important force to generate employment and more equitable income distribution, to activate competition, exploit niche markets, enhance productivity and technical change, and through all of these stimulate economic development. Besides, they are also less capital intensive, they are highly competitive, flexible and innovative. In support of this claim, Chimucheka and Rungani (2011) established that SMMEs are often the first to be offering new products in the market and they are more flexible than large organisations. This means that SMMEs can meet and satisfy customers' or the population's needs better than bigger businesses that lack flexibility (Boone & Kurtz, 2006, cited in Chimucheka & Rungani, 2011). The nature and financial performance of micro,

small and medium enterprises (MSMEs) over the last two decades indicate a horizontal expansion of enterprises in terms of increasing the number of establishments without them graduating to the next level from their existing micro, small and medium level (Moazzem,2013).

A study by Akingunola (2011) on specific financing options available to SMEs in Nigeria and contribution with economic growth via investment level, found out a significant positive relationship between SMEs financing and economic growth in Nigeria via investment level. Obwori et al. (2012) reported that the capital starvation of small scale industries is an economic development tragedy to growth of small and micro enterprises, and that the amount earned as profit from micro enterprises does not effectively support the growth of soapstone industry.

Soumadi and Hayajneh (2011) evaluated financial performance using ROE and the study revealed that financial leverage had significant negative relationship on firm performance. According to the study, the negative relationship was as a result of the firms' wish to finance its activities through increasing borrowing operations which leads to excess in borrowing and hence possible bankruptcy risks.

Moturi (2017) analyzed the effect of internal factors on the financial performance of firms in the cement manufacturing industry in Kenya. The study aimed to establish the influence of ownership structure, capital structure and size of the firm on the financial performance. This was a comparative study involving two cement manufacturing companies, namely, East African Portland Cement Company (EAPCC) and Bamburi Cement (BC), which were listed on the Nairobi Security Exchange. The study observed that the size of fixed assets had a significant negative impact on financial performance of BC Company while it had a positive significant relationship on EAPCC. As far as long term debt to asset ratio was concerned, the study realized that, EAPCC had a significant positive relationship with its financial performance whereas that for BC was not significant. In regard to debt to the relationship between equity ratio, debt ratio, gearing ratio and the size of their fixed assets, and financial performance, the study found out that EAPCC had a significant negative relationship.



Azhagaiah and Gavoury (2011) used profitability, Return on Capital Employed (ROCE) and Return on Assets (ROA) as indicators of financial performance in their research on the impact of capital structure on profitability, the study employed Total Debt to Total Assets and Debt-Equity Ratio as proxy for capital structure. Vătavu (2015) investigate the influence of capital structure on financial performance with special focus on the listed companies in Romania, and the study employed ROE and ROA as the indicators of financial performance. The study found out that performance in Romanian companies seemed to be higher when they use equity instead of debt as a form of financing. However, it was observed that manufacturing companies lack adequate internal funding to undertake profitable investments.

On seeking to investigate the impact of capital structure on firm performance, Ahmad et al. (2012) measured financial performance using Return on Asset (ROA) and Return on Equity (ROE). The study found out that only Short Term Debt (STD) and Total Debt (TD) have significant relationship with ROE and ROA. Wanambisi and Bwisa (201) used increase in income as the measure of performance in their study on the effects of microfinance lending on business performance of SMEs in Kitale Municipality. The study found out that the amount of loans has a significant positive relationship with performance. The other studies which have measured financial performance of firms using increase in profits, ROI and increase in sales volume include, Sekyewa (2009), Thirumalaisamy (2013), Ngugi (2013) and Salminen (2013). It is for this reason that this study has adopted these three as measures of growth.

#### **2.4.2 Internal Equity Financing**

Internal sources of finance are often preferable to a firm as they will usually be cheaper and perhaps easier to arrange at short notice (Koch & Macdonald, 2000 as cited in Njeru, 2013). The main sources of internal finance, according to Njeru (2013), are personal savings, profits, sale of assets (or lease back), and savings from reduced capital. Nawi (2015) defines personal savings as the owner's financial sources and these include owner's cash, personal credit cards, personal loans, winnings, inheritance, or investment income. Fairlie and Robb (2007) recognized the

importance of funds from family and friends as very important for SMEs, especially in supporting ethnic minority businesses or family businesses. Wang (2013) showed the importance of using personal funds as a source of finance in business by stating that it on average, doubling the percentage weight of personal funds increases the net profit growth and revenue growth by about 11% and 25.6% respectively. The study goes on to state that, having sufficient personal funds is equivalent to having precautionary savings when facing financial distress. Woods (2009) opined that micro enterprises result in sale of asset only when firms are unable to get finance from any other sources. The study quickly underscores such an action by stating that, selling a firm's an asset, may make the firm to stop offering certain goods or services.

MSEs are generally undercapitalized, suggesting major operational difficulties in accessing credit and pursuing corporate goals (Olutunla & Obamuyi, 2008). As much as it appears difficult to predict the effect of concentrated or dispersed ownership on firm performance unless one controls for the firm's capital structure choice (Mahrt-Smith, 2005), some studies have been done and shown positive linear relationships between ownership structure and firm performance (Davies et al., 2005).

Lewellen and Lewellen (2006) documented that internal financing is advantageous over external financing due to tax reasons because the payouts to shareholders accelerate personal taxes, so retaining cash inside the firm defers personal taxes – that helps offset the tax disadvantage of equity. Afrasiabi and Ahmadiania (2011) observed that companies which have financed their businesses through issuance of stock have got less risk and higher return. In particular, the firms had a better performance against systematic risks and had more value creation for its shareholders. Olutunla and Obamuyi (2008) lament that there is a huge supply of both equity and loanable funds in the commercial banking sector which the SMEs are not benefiting from in Nigeria.

Abay, Tessema and Gebreegziabher (2014) held that majority of the SMEs start their business either with personal savings or funds borrowed from relatives and friend. The study goes on to state that, most of these SMEs are started with small amount of

initial capital due to low economic status of the micro enterprise owners are poor. Only a handful of them manage to secure their capital from loans obtained from informal credit mechanisms which exist within their community, but rarely from the formal sector institutions.

Mateev and Anastasov (2010) studied on the determinants of small and medium sized fast growing enterprises in central and Eastern Europe. The study aimed to discover the main elements of growth in SMEs in Eastern and Central Europe. To achieve this, the study involved a panel dataset of 560 fast growing small and medium enterprises from which were drawn from six transition economies. From the study, it was revealed that current liquidity, leverage, internally generated funds, future growth opportunities and factor productivity were of paramount importance in determining a firm's growth and performance, while age and ownership do not seem to be able to explain firm growth. In view of this, the study recommended that governments in transition economies need to focus more attention to small and medium sized enterprises and try to create a business atmosphere that will be valuable for SME development.

Bayrakdarođluet et al. (2013) researched on the panel data analysis of capital structure determinants. This was an empirical study results from Turkish Capital Market. The study aimed to determine whether firm-specific capital structure determinants in the developing market of Turkey support the capital structure theories which were established to describe the company structure in developed countries. By examining the capital structure of 242 companies of different sectors that were operated in Istanbul Stock Exchange in the period of 2000-2009 the study established that Turkish companies do not have debt ratio targets and that trade-off theory is less successful than the pecking order hypothesis in explaining the capital structure of the Turkish companies. This study left a gap because it focused only on the firms listed so as to arrive at its conclusions. Therefore this study seeks to fill the gap by looking at the SMEs.

Abor (2005) did an empirical analysis to determine the effect of capital structure on profitability. This study was done among the listed enterprises in Ghana. The main

objective of the study was to establish the relationship that exists between capital structure and profitability of the companies listed on the Ghana Stock Exchange (GSE) during a five-year period. To achieve this objective, a link between ROE and capital structure was determined using regression analysis. The findings from the study observed that there existed a positive significant relationship between ROE and the ratio of short-term debt to total assets. However, the study recorded a negative significant relationship between ROE and the ratio of long-term debt to total assets. As far as the relationship between return rates and total debt was concerned, the study identified a significant positive relationship between return on equity and the ratio of total debt to total assets. This study by Abor (2005) was distinct from this study in the sense that it also focused on listed companies while this study seeks to look at microenterprises.

Olutunla and Obamuyi (2008) wanted to know the factors associated with the profitability of Small and medium enterprises in Nigeria. To achieve this, the study analyzed the connection between bank loans, profitability, size and age of the small and medium enterprises in Nigeria. By adopting a fixed-effects regression model to study a panel data of 115 randomly selected SMEs of existing firms which either had taken loans or had an active loans, the findings revealed that there was a huge supply of both equity and loanable funds in the commercial banking sector in Nigeria which the SMEs are not benefiting from. On the demand side, the study lamented that the SMEs have been reluctant to seek bank loans despite the various loan schemes being offered by the banks and the government, because of the fear of the business being taking away in case of any problem to meet the agreed terms. It was recommended that the government should come up with policies that will force commercial banks to relax their restrictive loaning regulations and operations which were viewed as major hindrances to borrowing. Recommendation was also passed on the need to dispatch more credit facilities for SMEs, and that, the government should permit the SMEs to access loans from the commercial banks through both formal and informal entrepreneurship education.

Afrasiabi and Ahmadinia (2011) observed that efficient use of debt leverage in capital structure causes decrease to credit risk and increase the firm credit to risk to

financial creditors. This is in unison with Koziol's (2006) claim that a higher volatility of asset value returns can be favorable for a high firm value under puttable debt, while it always destroys value of a firm with straight debt.

Daskalakis, Jarvis and Schizars (2013) looked at financing practices and preferences for Greece micro and small firms. The study aimed to analyze SMEs fund themselves; to explore what their financing favorites are; and to discover their attitudes on how they evaluate their sources of finance and the challenges they face when trying to apply for funding from those sources. Panel data methods was used to the sample of SMEs for the period 1998 to 2002 and an and the information was analyzed to determine the level to which the debt to assets ratio of firms depended on asset structure, firm size, profitability and growth. It was evident from the study that, micro and small enterprises rely heavily on their own funds and they would not manage to attract new equity from sources outside the family.

Thapa (2015) assessed the determinants of microenterprise performance in Nepal. The study aimed to examine those salient factors which facilitate the performance of micro enterprises in Nepal. The study used a sample of 501 micro-entrepreneurs randomly across different strata-gender, ethnicity, enterprise category and ecological belts in Nepal in 2013 for the years 2068 BS (April 2011–March 2012) and 2069 BS (April 2012–March 2013). The findings from the study revealed that the entrepreneur-related factors, particularly gender, managerial skills, need for achievement, need for autonomy, creative tendency, internal locus of control and managerial foresight; enterprise-related factors, particularly enterprise age, enterprise size and initial financial constraint; and environment-related factor, particularly social network, were the key factors determining the performance of microenterprises in Nepal. Bowen, Morara and Mureithi (2009) lamented that most small and micro enterprises in Kenya rely mainly on own savings and reinvested profits to finance their business.

### **2.4.3 Debt Financing**

Small Enterprises in Kenya face unique challenges, including lack of sufficient capital which inhibit their growth and profitability hence diminishing their contribution to sustainable development. Consequently, very few enterprises have made the transition from micro to medium scale (Lusimbo, 2016). According to the study, the transition of enterprises is important because it is when they become medium-sized that growth-oriented MSEs make their most tangible contribution to economic growth and job creation.

Debt financing refers to funds that are borrowed and must be repaid, with or without interest. There are several sources of debt financing for businesses and these include; commercial finance companies, hire purchase, share capital, and funds from SACCOs and credit unions, funds from friends, family finance and welfare groups (Nyanamba et al., 2013; Langdon & Bonham, 2004), supplier credit, leasing arrangements (Tariq, 2013). Other sources include asset-based lenders, trade credit, equipment suppliers, Stock brokerage houses, insurance companies, bonds, private placements, Small Business Investment Companies (SBICs) and Small Business Lending Companies (SBLCs).

Venture Capital Companies also provide equity financing besides the above sources (Lemuel, 2009). The size of the enterprise and its stage of growth or development impact upon its financial needs and determine the most likely suppliers of finance. Equity finance is important for young, high growth and potentially high-risk enterprises. The management prefers equity financing than debt financing because equity financing is not binding.

While some studies argue that loan size borrowed significantly and positively contribute to the development and financial performance of businesses especially micro and small enterprises, while other studies indicated that micro enterprises that accessed MFIs loans did not show any sign of growth in financial performance (Wanambisi, & Bwisa, 2013). Though the study by Moyi (2013) also failed to confirm any important role for the credit constraint in limiting small firm

employment growth, it observed that the marginal effect of the credit constraint on firm growth mainly depended on access to workspace, access to technology and formality status. It is evident from literature that not all small businesses are growth oriented and for certain firms' growth is a voluntary choice (Masurel & Montfort, 2006). Mwaka (2006) further argues that a firm that relies too much on debt suffers from high charges of interest rates and this may utilize further returns required for future growth as well as jeopardizing its operations.

Report by European Commission (2009) lamented that large financial banks have considerably reduced lending to small scale enterprises thus inhibiting their potential for growth and financial performance. Robb and Robinson (2008) identified debt financing as the major sources of capital for emerging enterprises since the retained earnings are inadequate or not obtainable. In support of this claim, Baum Schafer and Talavera (2007) reported that many smaller, less liquid firms do not easily attract funds from debt markets although they can acquire external funds through loans from associated firms, bank lending, trade credit and other means.

Credit facilities form an integral part of micro enterprise development. It is essential in starting, expanding or improving the productivity of an enterprise (Odero-Wanga, Mulu-Mutuku & Ali-Olubandwa, 2013). However, the results of Akingunola (2011) warned that the financial sector has dismally satisfied the financing need of the small and medium enterprises sub-sector while its micro enterprises counterpart has been completely abandoned. Kibet et al. (2015) attested that despite the fact that small and micro enterprises play a substantial role of the SMEs in sub Saharan Africa's economies, they are denied official support, particularly credit, from institutionalized financial service organizations that provide funds to businesses. Bowen et al. (2009) on management of business challenges among small and micro enterprises in Nairobi-Kenya identified competition, insecurity, debt collection, lack of working capital and power interruptions as the top five cited challenges facing businesses in Nairobi.

According to Githaiga and Kabiru (2015) SMEs rely on debt financing, first because debt financing is moderately cheaper compared to equity financing, and secondly

because the enterprises have inadequate track records, resulting in a relatively higher risk for capital suppliers. Sharma and Gounder (2011) observed that the micro and small enterprises were constrained by banks' interest rates, fees and charges, and collateral requirements thus making it hard for them to secure loan. Biswas (2014) cited lack of credit from banks as one of the major challenges faced by MSME'S in India. According to the study, the banks are not providing the adequate amount of loan to the MSMEs and that besides, the loan providing process of the banks is very long and formalistic in the sense that the owners of the MSMEs have to produce different types of documents to prove their worthiness. It was also observed that on average, the banks provide on an average 50% total capital employed in fixed assets.

Harvey, Lins and Roper (2004) noted that leverage helps mitigate the loss in firm value attributable to the separation of management control and ownership. This beneficial effect of debt is concentrated in firms that have either a relatively high percentage of assets in place or few growth opportunities. The study also stressed that when a meaningful conflict exists between outside shareholders and management due to the separation of ownership and control, debt helps to discourage overinvestment of free cash flow by self-serving managers. Besides, financial experts traditionally believed that increasing a company's leverage that is, increasing the proportion of debt in the company's capital structure, would increase value up to a point where further increases in leverage would increase the company's overall cost of capital and decrease its total market value (Chowdhury & Chowdhury, 2010).

Brendea (2012) indicated that firms with more profitable projects are prone to use internal funds rather than debt. However, Faulkender and Petersen (2006) contradicts this opinion by stating that when these firms discover that the net benefit of debt is positive, they will move toward their preferred capital structure by issuing additional debt and/or reducing their equity. This is due to the assumption that a firm's leverage is completely a function of a firm's demand for debt. This is supported by Harvey et al. (2004) who opine that the benefits to debt could be greater when management has a large base of assets in place that it can exploit, because assets in place generate cash flow that can lead to either overinvestment or the outright diversion of corporate funds; or when management has few future growth opportunities, because when a



firm has expected future growth opportunities, debt can limit management's ability to pursue positive net present value projects, leading to ex-post underinvestment.

Wanjohi (2010) observed that lack of access to credit is almost universally indicated as a key problem for SME's. According to the study, this affects technology choice by limiting the number of alternatives that can be considered. He further states that many SME's may use an inappropriate technology because it is the only one they can afford while in some cases, even where credit is available, the entrepreneur may lack freedom of choice because the lending conditions may force the purchase of heavy, immovable equipment that can serve as collateral for the loan. Olutunla and Obamuyi (2008) that the growth of SMEs is not just dependent on accessing bank loan but accessing the right size of loan at the right time. Lemuel (2009) laments that a low proportion of small firms' assets are financed by shareholders; so debt-to-equity ratios are relatively high compared to larger firms. The results of a study by Abiola (2012) on the effects of microfinance on micro and small enterprises growth lamented that microfinance banks do not enhance growth and expansion capacity of micro and small enterprise in Nigeria. Olinski (2006) acknowledged that SMEs have limited capital and that this restricts their access to new technologies or innovations.

Chowdhury and Chowdhury's (2010) study tested the influence of debt-equity structure on the value of shares given different sizes, industries and growth opportunities with the companies incorporated in Dhaka Stock Exchange and Chittagong Stock Exchange of Bangladesh. The findings of the study revealed that maximizing the wealth of shareholders requires a perfect combination of debt and equity, whereas cost of capital has a negative correlation in this decision and it has to be as minimum as possible. This is also seen that by changing the capital structure composition a firm can increase its value in the market. Nonetheless, this could be a significant policy implication for finance managers, because they can utilize debt to form optimal capital structure to maximize the wealth of shareholders.

Kehinde (2012) cited in Nasieku and Karanja (2016) in a study conducted between 2010 and 2012 examined the connection that exists between the capital structure mix of the SMEs and the overall performance of the businesses over the years in Nigeria

and discovered that most SMEs have an all equity finance structure and has a less debt finance compared to equity finance. It also revealed that the earning, survival and performance of the SMEs is strongly influenced by their capital structure mix.

Idowu (2009) observed that lack of both major debt and equity financing greatly hindered rapid development of the SME sector in Nigeria yet these two (debt and equity financing) are vital in order for SMEs to succeed in their drive to build productive capacity, to compete, to create jobs and to contribute to poverty alleviation in developing countries. The study further noted that, financial institutions in Africa set very tough conditions for small business because they see SMEs as a risk because of poor guarantees and lack of information about their ability to repay loans. In support of this claim, its hard for SMEs to acquire or absorb new technologies nor expand to compete in global markets or even strike business linkages with larger firms without adequate capital (UNCTAD, 2002).

In South Africa, Clover and Darroch (2005) surveyed 44 small, medium and micro-enterprise agribusinesses in an effort to identify policies and strategies that can be adopted in order to increase the survival and growth rates of public and private sector institutions in KwaZulu-Natal (KZN), and documented that funding constraints at start-up and lack of collateral were some of the constraints that frustrate growth of the enterprises. Bekele and Zekele (2008) reiterated that there was a high failure rate among well-established small businesses and enterprises in Ethiopia regardless of the fact that these enterprises sector contributes significantly to the national economy. The study further noted that lack inadequate finance as the major cause for the businesses that ceased operation.

A research by Nyanamba et al. (2013) on the factors that determine the capital structure among micro-enterprises, found out that major determinants of the capital structure of micro-enterprises as being access to capital markets, size of the business, profitability of the business and lender's attitude towards the firm. Banks and financial institutions were noted as the most preferred form of external financing for the micro-enterprises. The study concluded that there are a number of factors affecting the capital structure of micro-enterprises and that micro-enterprises prefer

borrowing from various external sources and this affects the capital structure of the micro enterprises.

Palacios, Carrillo and Guzmán (2016) developed sufficient proof to show that SMEs have limited access to debt financing unlike large companies and, for this reason, they are forced to rely more on self-generated funds (own resources) or on short-term debt. In support of this claim, Cassar (2004) cited in Silva (2015) studied the types of financing used by startups in the early years of operation and the results indicated that external financing represented almost half (40.2%) of the capital of new firms, where 16.9% of the financing was provided by bank financing.

According to Olinski (2006), the prosperity of a given state and effective functioning of market mechanism depend on the extent to which middle class has developed in a particular society, and that, in order reduce these enterprises' market failures and difficulty they encounter when generating capital or obtaining a credit, especially when starting a business, some countries have started to pursue active policy supporting entrepreneurship as well as small and medium enterprises. The actions involve, among other things, the creation of conditions favourable to running a business as well as providing direct access to funding.

Memba (2011) defined venture capital as equity or equity-linked investments in young privately held companies, where the investor is a financial intermediary who is typically active as a director, advisor, or even a manager of the firm. Lemuel (2009) observed that the main characteristics of Venture Capital Companies (VCCs) is that they offer both equity and debt finance and take a more active and specialist interest in the management of the ventures they support. Their main function is the financing of small firms and new ventures, although they have gradually progressed to financing infrastructure and other major projects that governments delegate to the private sector for more efficient construction and management. Huang and Ritter (2004) discovered that firms prefer internally generated funds, and raise external funds only if internal funds are insufficient. If external funds are required, they prefer straight debt, then convertible debt, and finally external equity. This claim is supported by Miglo (2010) who reveals that low-quality firms tend to use external

sources more frequently because they do not have as much profits and retained earnings as high-quality firms. Besides, a study by Blass and Yoshua (2013) also revealed that publicly listed firms preferred external financing as opposed to internal financing, in order to finance their activities. Hovakimian's (2004) study on the role of target leverage in issuance and repurchasing activities revealed that equity issues and repurchases have no significant lasting effect on capital structure but debt issues and repurchases do.

Palacios et al. (2016) on the effects of the capital structure in performance of SMEs of México, concluded that the external sources of financing have a positive influence, but insignificantly in performance. Carvalho (2009) examined the effect of the level of institutional development across the different Brazilian states on the choice of external financing of Brazilian firms. These firms were drawn from nine industrial sectors namely, food processing, textiles, garments, shoes and leather, chemicals, machinery, electronics, auto-parts, and furniture from across 13 federal states. The findings of the study found out that, financial development has a positive impact on the use of the same sources and that, this effect is more severe on smallest firms. Abdul (2012) conducted a similar study to determine the relationship between capital structure decisions and the performance of firms in Pakistan. The study concluded that financial leverage has a significant negative relationship with firm performance. Paul (2014) in the study on the role of entrepreneurial leadership in the growth of micro and small enterprises, found out that there exists a positive correlation between motivation, entrepreneurial influence, mentorship, delegation of duties and financial performance of micro and small enterprises.

Ongoro (2013) showed that finance significantly enhanced micro enterprises in Kenya and that lack of finance posed a major challenge among the micro enterprises in Kenya. A study by Mwobobia (2012) on the challenges facing women's small and micro enterprises in Kenya lack of finance, discrimination, problems with the city council, multiple duties, poor access to justice, lack of education as some of the challenges facing women, and recommended that women entrepreneurs need to be supported financially, legally and more capacity building should be made available.

Margaritis and Psillaki (2010) studied on capital structure, equity ownership and firm performance. The study aimed at investigating the relationship between capital structure, ownership structure and firm performance across different industries using a sample of French manufacturing firms. The study found supportive evidence to show that firms with more concentrated ownership face lower agency costs only in chemicals. However, the study did not find a statistically significant relationship between ownership structure and firm performance in the computers and textiles industries. It was also evident from the study that in the upper range of the leverage Distribution, the income effect resulting from the economic rents generated by high efficiency offsets the substitution effect of debt for equity capital and that more dispersed ownership structures are generally associated with less debt in the capital structure except for highly leveraged firms in the textiles industry.

Abeywardhana and Krishanthi (2012) studied financing decision, cost of debt and profitability among the non-financial SMEs in the UK. The main objectives of the study was to establish the causes of capital structure and change process, determinants of cost of debt and the effect of capital structure on profitability with respect to non-financial SMEs in the UK. The study analyzed data from a sample of 3984 SMEs. The findings of the study revealed that the firms obeyed the trade-off theory, pecking order theory and agency theory when making financial decisions. The study further observed that short term debt influences cost of debt, capital structure and profitability of SMEs; and that, although short term debt is more expensive for the manufacturing sector, it seems more profitable for service sector. The study only concentrated on debt as a form of capital with no regard to the other forms of capital dealt with in this study (internal and retained earnings). Besides it only used profitability as the measure of performance.

Ahmad et al. (2012) sought to investigate the impact of capital structure on firm performance in Malaysia. The study was interested in analyzing the relationship between operating performance of Malaysian firms, measured by return on asset (ROA) and return on equity (ROE) with short-term debt (STD), long-term debt (LTD) and total debt (TD). Using a sample of 358 observations from 58 firms between the year 2005 through 2010, the study found out that only STD and TD

have significant relationship with ROA while ROE has significant on each of debt level. This study took into focused on consumers and industrials sectors at large, and took into consideration ROE and ROA as the measures of performance.

Bandyopadhyay's (2005) study on the effect of capital structure on manufacturing firms' product performance in India realized that long-term debt enhances growth in sales for firms belonging to the top 50 small and large business houses. However, the study further noted that long term debt is insequential for growth of sales for smaller group and unaffiliated firms. This study only sought to establish the link between capital and the firm's performance as far as sales is concerned, but ignored other measures of financial performance like profitability and ROE.

In Nigeria, Babajide (2012) wanted to know the link that existed between microfinance on micro and small business performance in Nigeria. The objectives of the study were to investigate the effects of various loan administration practices (in terms of loan size and tenor) on small enterprises financial performance criteria, and to investigate the ability of Microfinance-Banks (MFBs) (given its loan-size and rates of interest charged) towards transforming micro-businesses to formal small scale enterprises. The study was a survey of 502 respondents which was obtained through simple random sampling technique from the list of enterprises which had been financed by various microfinance banks in Nigeria. The findings of the study discovered that access to loans had no significant influence on the financial performance of micro and small enterprises in Nigeria, and this was attributed to the fact that the size of the loan is too small to cause any substantive impact on small firms. However, the study noted a strong positive effect of other firm level characteristics such as business size and business location, on enterprise growth. In view of this, the research recommended that recapitalization of the Microfinance banks to enhance their capacity to support small business growth and expansion. This study only paid attention to debt financing, and their effect on both small and medium enterprises, with no regard to the other forms of financing.

Evbuomwan et al.'s (2012) study on preferences of micro, small and medium scale enterprises to financial products in Nigeria. The study aimed to determine the

inclinations of MSMEs to financial products in Nigeria so as to adequately target them. Data was obtained from 100 respondents chosen from the 312 project to which credit had been advanced, between the period 2001 and 2009. The findings revealed that 75.7% of the respondents depend on own funds to finance their businesses. The study cited inadequate fund/working capital, poor power supply and inadequate infrastructure as the major problems which are faced by the Small and Medium Enterprises. It was also revealed from the study that majority of the respondents prefer loan so that they can maintain full control of their businesses. The study recommended that credit programmes that will take cognizance of the peculiarities of MSMEs in Nigeria be intensified so as to increase their access to funds in view of their dominance and potential contribution to the economy. Evbuomwan et al.'s (2012) study had shortcoming relative to this study in the sense that it did not look at retained earnings as a form of financing. Besides, it looked at SMEs in lump sum while this study specifically focuses on craft micro enterprises. The study also failed to look at the link between the elements of capital structure and profitability, ROE and sales.

Abor (2007) on capital structure and financing of SMEs in Ghana and South Africa, found out that bank financing accounts for less than a quarter of SMEs' debt financing, with short-term bank credit representing the greater proportion of bank finance. It was also evident from the study that age, size, growth of the firm and asset tangibility have positive associations with long-term bank debt, while profitability is negatively related to long-term bank debt. Short-term debt was found to be positively correlated with size, though negatively related with profitability, and growth. Further analysis revealed that Ghanaian small and medium sized non-traditional exporters' (NTEs) mostly relied on formal financing sources, especially bank finance. This study dwelt on debt financing which is just one of the components of financing.

Akoto (2014) documented a study on the impact of micro credit on small businesses in Ghana. The study used a causal and descriptive research design to determine the link between access to credit and sales performance in the SME sector. Data were obtained from a sample of 120 SMEs. It was found out that, although the main reason behind loan advance to micro enterprises in the form of micro credit was to

eradicate poverty by developing new markets and by promoting a culture of entrepreneurship, it was also observed that micro credit has minimal state intervention, thereby shifting the focus of attention away from the society towards individuals. It was recommended that the SME owners should be enlightened on the repercussions of their acts on the enterprises as far as the loan repayment was concern. That is, they should use income from the business only to service the loans, and that the loan products be able to satisfy the financial needs of a wider range of household economic activities, for this will assist in reducing diversion of the loaned money and also result in significant reduction in the defaulting rate of loanees.

In Ghana, Abor (2005) noted that profitable firms depend more on debt as their main financing option. It was also observed that a high proportion (85 percent) of the debt is represented in short-term debt. The study revealed a significantly positive relation between the ratio of short-term debt to total assets and ROE. However, a negative relationship between the ratio of long-term debt to total assets and ROE was found. With regard to the relationship between total debt and return rates, the results show a significantly positive association between the ratio of total debt to total assets and return on equity.

Osie-Assibey (2010) studied the source of finance matters on the performance of microenterprises in Ghana, realized that 69.3% of the entrepreneurs used self-finance as the main source of start-up capital for these microenterprises while only 28.6% of the enterprises used informal finance from friends and relatives. Almost 90% of all the MSEs did not seek any credit to finance their working capital needs. The study went ahead to warn that it is not prudent for an enterprise to rely too much on grant and internal source of finance, compared to debt finance because this has leads to tendency to undermine the motivation and incentive for a microentrepreneur to be innovative in bringing about a higher productivity. The study observed that awareness of appropriate sources, and access to a more formal finance lead to increased productivity of the enterprises and that, having access to semi-formal and formal financial institutions do not only afford microentrepreneurs to make the needed investment in innovations and newest vintage of capital stocks, which embodied modern technologies and productive efficiencies, but also MSEs are more



likely to receive technical and managerial advice that will eventually lead to higher productivity and growth. The study did not identify the link between finance sources and financial performance of craft microenterprises specifically, but rather from micro and small enterprises.

Abay et al. (2014) investigated the external factors affecting the growth of micro and small enterprises (MSEs) in Ethiopia. The main objective of this study was to investigate external factors affecting the growth of MSEs by using semi-structured questionnaire covering 160 randomly selected MSEs from five Kebeles of Shire Indasselassie Town. The study findings revealed that those MSEs having access to sufficient infrastructure and access to own working premise are growing rapidly than of those MSEs that are operating with limited access to infrastructure and operating at rented and family working premise. Of unique concern was also the fact that, MSEs that have no access to credit are rapidly growing than those of MSEs having access to credit. The study recommended that, due to the importance of MSEs in job creation, income generation and poverty alleviation, all stakeholders (government and non-governmental institutions) should make intensive effort to remove the factors that stand on the growth of the MSE. This study left a gap in the sense that it only sought the external factors which influence growth of both micro and small enterprises. It did not put into consideration the fact that there is heterogeneity among the enterprises themselves, which may influence the growth patterns.

Sekyewa (2009) analyzed the determinants of accessibility to long-term finance and its effect on growth of EIB-funded small and medium size enterprises in Uganda's hotel industry. The main objectives of the study were to examine the level of business growth of the SMEs in Uganda's Hotel industry, to investigate the level at which these SMEs access long-term finance extended by the EIB-APEX, to establish the factors influencing the level of this access, and to examine the relationship between the level of business growth of these SMEs and their level of access to long-term finance. The findings revealed that the level of business growth of the SMEs in Uganda's Hotel industry was 46.3% predicted by the level of the SMEs' access to EIB-APEX long-term finance and that SME competences had the most significant influence on the level of SMEs' access to this finance. The study concluded by

stating that there is need to improve the level of business growth of the SMEs. The study recommended that SME management and lending institutions should improve the SMEs' access to loan finance by solving the flaws in the factors influencing this access. It is evident that in this study, only one form of capital (debt) was paid attention to, in an effort to determine its connection with growth (and not financial performance) of the SMEs in the hotel industry only. The other aspects of capital structure, that is, internal equity and retained earnings, were not considered in the study.

Maina (2014) wanted to know the effect of capital structure on financial performance of small and medium enterprises in dairy sector in Kiambu County, Kenya. Using a casual research design on a sample of 50 respondents drawn from the 71 SMEs in Kiambu County, the study revealed that the SMEs were funded mainly through debt and lesser through equity; that the SMEs have more assets than current liabilities and which were acquired through debt. The study further indicated that debt equity has a negative impact on the performance of SMEs in dairy sector. Though this study looked at the connection between capital structure and financial performance, it narrowed itself to SMEs in the dairy sector, leaving the craft industry at bay.

Githaiga and Kabiru (2015) sought to know the connection between debt financing and financial performance of small and medium size enterprises in Kenya, using Eldoret as the focus for the study. The main aim of the study was to determine the importance of debt structure (long-term, trade credit and short-term debt) in financing SMEs. To achieve this aim, the study used descriptive and explanatory research design. By using a sample of 150 SMEs, drawn using stratified random sampling technique, the study revealed that both long term loans and short term loans had negative impact on financial performance of SMEs. It is in view of this that the study recommended that the SMEs should lay down payment modes for trade credits, clearly stipulate the payment schedules, in an effort to deter poor credit and loan control policies. In this study, only debt financing was focused on, both the small and medium enterprises were investigated. This means that it did not ascertain the importance of capital structure with respect to the craft micro enterprises.

Lusimbo (2016) investigated the relationship between financial literacy and the growth of micro and small enterprises MSEs in Kenya, with special focus on Kakamega Central sub- county, Kenya. The main aim of the study was to determine the relationship between financial literacy and the growth of MSEs in Kenya. The study sampled 306 MSEs from the 1300 MSEs registered under the single business permit in Kakamega Central Sub County as of 2015, using stratified proportionate sampling technique. Descriptive cross sectional survey design was employed in the study. The findings from the study showed that although MSE managers had a fair knowledge of debt management, majority do not understand the effect of inflation and interest rates on loans they borrow and were not comparing terms and conditions before purchasing financial products which could affect their financial decisions of when to borrow, how much and from whom, leading to sub- optimal business performance. It was also evident from the study that those businesses whose managers have low financial literacy have recorded minimal or no growth over the years. In view of this, the study recommended on the need to organize financial literacy training programs for MSEs across the county, Incorporating financial education in the school curriculum from Primary level so that individuals are financially informed early in life. This research was contented with the financial literacy and not capital structure of the micro enterprises.

Odero-Wanga et al. (2013) researched on the strategies used by women entrepreneurs in milk micro enterprises in Kenya. The study aimed at examining the strategies used by women in milk micro enterprises to ensure the survival of their enterprises in Kenya. The sample constituted 108 women entrepreneurs who were selected using stratified, simple random, purposive and snowball sampling methods. The study found out that the strategies used by women to sustain their enterprises included accessing credit facilities from relatives and friends; using low level technologies; operating their businesses illegally to avoid heavy licensing costs; and managing their enterprises close to home. While these strategies allowed the women to operate their enterprises at a certain level, they are unlikely to encourage the growth and sustainability of women owned micro enterprises. The study recommended that policy interventions need to be put in place to increase the success rates of women owned enterprises. Besides, policy intervention is needed to make

technological input more accessible and affordable, there is need for policies that will streamline the delivery of credit from this sector, and that the top down approaches that deny women's participation in decision making process that affects them and their enterprises, should be avoided. This study addressed women entrepreneurs only, yet the industry also has men and youths. Besides, it narrowed itself to milk industry, whose market and necessity is quite different from that of craft micro enterprises. The fact that it was done in three districts (Nairobi, Kiambu and Nakuru) only made it lack representativeness of the whole country.

Njuguna (2015) wanted to know the factors affecting effective participation of micro and small enterprises in public procurement in Kenya. The main aim of the study was to investigate the challenges to effective participation of micro and small enterprises (MSEs) in public procurement market in Kenya. Specifically, the study sought to establish how MSEs' capability, information accessibility, access to finance and competitive environment pose challenges to MSEs' participation in public procurement market in Kenya. Out of a target population of 519,385 MSEs in Nairobi County 384 MSE owner-mangers and 15 chief procurement officers/managers were sampled. The findings of the study revealed that a majority of MSEs are not trained in procurement/supply chain management. It was also evident from the study that, access to tender information was found to be irregular limiting MSEs' chances of participating in public tenders. The major challenges cited include favouritism, nepotism, clanism, tribalism, complicity among fund officials, inadequate information about available funding opportunities, and political differences. Majority of MSEs were found lack the necessary financial support to invest in modern technologies, advertise their products and services and provide quality services demanded by the government. Though this study was done in Kenya and touched on micro enterprises, it had neither had something to do with capital structure nor on financial performance.

Sabana (2014) was interested in entrepreneur financial literacy, financial access, transaction costs and performance of micro enterprises in Nairobi City County, Kenya. The study sought to establish the relationship between entrepreneur financial literacy, financial access, transaction costs and performance of microenterprises in

Nairobi County, Kenya. The specific objectives of the study were; to establish the relationship between entrepreneur financial literacy and performance of microenterprises; to determine the relationship between entrepreneur financial literacy and financial access; to establish the influence of financial access on the relationship between financial literacy and performance of microenterprises; to assess the influence of transaction costs on the relationship between financial literacy and the performance of microenterprises and to determine the joint influence of entrepreneur financial literacy, financial access and transaction costs on the performance of microenterprises. The study adopted a cross-section design on a sample of 396 microenterprises drawn from Nairobi County. The study revealed that entrepreneur financial literacy had a statistically significant influence not only on enterprise performance but also on financial access. The study also revealed that intervening influence of financial access on the relationship between entrepreneur financial literacy and performance microenterprises was statistically significant and that transaction costs had a statistically significant moderating influence on the relationship between entrepreneur financial literacy and performance of microenterprises. This research had nothing to do with capital structure but rather entrepreneur financial literacy.

Simeyo, Lumumba, Nyabwanga, Ojera and Odondo (2011) on the effect of provision of micro finance on the performance of micro enterprises, observed that the rapid growth of micro finance institutions (MFIs) has made micro and small enterprises to access credit more than doubled from 7.5% in 2006 to 17.9% in 2009 leading to the conclusion that, provision of micro finance to the youth to engage in micro enterprise activities will help spur economic development and alleviate youth unemployment, in line with Kenya's vision 2030. Only one form of financing (debt) was discussed in this study, and it pegged its argument on microenterprise in general.

#### **2.4.4 Retained Earnings**

Retained earnings are as a result of undistributed net income, prior period adjustments (error corrections) and certain changes in accounting principle, and adjustment due to quasi reorganization. Although retained earnings are the most

preferred source of finance for small businesses in most of the countries (Ou & Haynes, 2006), some enterprises may exhibit a high mix of debt-to-equity because they are unable to generate retained earnings (Chepkemoi, 2013). The results of Hermelo and Vassolo (2007) held that retained earnings are used as sources to finance new projects in emerging enterprises where capital markets are not well. The study further notes that however, firms in the startup period, when initial investments have not matured yet or with investment projects substantially larger than their current earnings will not have enough financial means from retained earnings and will reach a constraint in their growth project.

Yazdanfar (2012) investigated the impact of financial structures on the growth of micro firms in Sweden and realized that retained profit significantly influenced growth of micro enterprises more than short-term debt. A study by Hsiao, Hsu and Hsu (2009) on the East Asian Tigers and Japan, observed that firms in these regions prefer to use retained earnings for two main reasons. First, firms with high profitability can obtain high retained earnings and when there is any financial deficit, the firms would use internal fund rather than fund from outside, implying that profitability would be negative to firms' leverage. Secondly, firms with higher profitability can obtain more net income and lead to more retained earnings to fit the additional funds needed, so debt issued would drop as profitability goes up. Gregory, Matthew, Oswald and Gardiner (2005) agreed with the claim by stating that mature firms are often able to use retained earnings as a source of financing, and thus do not require as much external financing and this is attributed to the fact that they have lower growth rates.

A survey by Moazzem (2013) in Bangladesh realized that 75% of capital required for small firms comes from retained earnings, while in those in Ecuador, Philippines and Brazil use 46%, 58% and 59% respectively as their retained earnings contribution towards their capital requirements. This means that, given the limited retained earnings of small scale enterprises; it would take about 15 years for them to be at a stage of having capital similar to that in large enterprises, provided that growth and level of inflation remained the same.

The findings of Akingunola (2011) revealed that a great number of small scale enterprises in Nigeria used internal sources of finance, mainly personal savings and retained earnings in the financing of capital equipment (Akingunola, 2011). Nasieku and Karanja (2016) opined that profitable firms are likely to use retained earnings and make less use of debt relative to less profitable firms. Similar sediments were shared in theoretical framework by Kibet et al. (2015) which indicated that when retained earnings are insufficient, they small scale firms will opt for debt rather than equity finance, because debt providers, with a prior claim on the firm's assets and earnings, are less exposed than equity investors to errors in valuing the firm. However, Akingunola and Oyetayo (2014) refuted the claim by stating that young firms tend to be externally financed while older tend to accumulate retained earnings (Akingunola & Oyetayo, 2014).

Ouma and Rambo (2015) discovered that small scale enterprises in Kenya relied on retained earnings and loans from informal associations, which are often unpredictable, unsecure and have a limited scope for risk sharing. This claim is supported by the findings of Akoto (2014) on the impact of micro credit on small businesses which realized that retained earnings are one of the most important sources to finance new projects in emerging economies where capital markets are not well developed. The study however noted that, firms in the startup period, when initial investments have not matured yet or whose investment projects are substantially larger than their current earnings, will not have enough financial means from retained earnings and will face a constraint in their growth project. According to the study, this may make the firms to seek external sources of financing; although the extent of borrowing could be limited by internal factors like high debt-equity ratios that would expose both borrower and lender to increased risk. This finding is in harmony with Chepkemoi (2013) who indicated that smaller businesses are heavily reliant on retained earnings to finance their investment flows and obtain most of additional finance from banks, while other resources, especially equity, are less important. In support of this claim, Brighi and Torluccio (2007) noted that on average, self-financing as a major form of finance is the preferred choice of the youngest firms.

Bayrakdaroğlu et al. (2013) demonstrated that that the highly profitable Turkish companies prefer retained earnings as their funds, thus, their debt ratio is low. This, the study claims, shows that the companies run lower risk of bankruptcy and consequently, leads to a decrease in the debt ratio of the companies in the capital structure hence leading to an increase in equity value. This behavior is in unison with the Pecking order theory which stipulates that in the presence of asymmetric information, a firm will prefer internal finance, but would issue debt if internal finance was exhausted.

Thirumalaisamy (2013) investigated on firm growth and retained earnings behavior. This was a case study of Indian Firms. The study used a random sample of 149 firms, which were considered as the most profitable for a period of 15 years from 1996-2010, the study revealed that amidst the moderate-growth firms, their fixed assets and the fixed capital requirements were financed to a great extent by equity capital and retained earnings rather than debt capital. The study also revealed that external capital, cash flow and dividend are the most influential variables showing high degree of impact on retained earnings and that on average the interest payments has not substantially reduced the retained profits. It was also evident from the study that cash flow and external sources of funds and dividend are the prominent factors influencing the retained earnings among low-growth companies. However, the study also observed that investment in fixed assets and inventory are significantly and negatively associated with retained earnings which mean that these needs are financed by external sources of funds and retained earnings are substitutable to external funds. Lastly, it was noted from the study that cash flow and dividend are found to be the most influencing variables on retained earnings. This study connected debt finance and their relationship with retained earnings, and concentrated on profitable firms to gather their data.

Mahakud's (2005) study on data obtained from 500 companies listed in the Indian stock market, showed that corporate retained earnings in India has not increased much and but remained at a low level throughout the period of study. The study realized that profit after tax, investment opportunities, availability of external funds,



cost of borrowing, dividend policy and shareholding patterns are major determinants of retained earnings.

Kauffmann (2005) realized that Africa's SMEs usually depend on retained earnings, informal savings, among other savings, as the main source of funds. Obwori et al. (2012) discovered that most of the income generated from the soap stone business small scale enterprises in Tabaka is used for buying personal effects, food and children education. However, the study noted that only a few SMEs spent the income to improve their skills, expansion of their businesses, or towards improving and growing the soapstone businesses.

A survey by Simeyo, Lumumba, Nyabwanga, Ojera and Odondo (2011) affirmed that savings mobilization approach among micro enterprises in Kenya encouraged the entrepreneurs to postpone consumption in favor of savings so as to provide the much needed financial resources for micro enterprise growth. According to the study, such savings accumulate into a lump sum in the future and act as retained earnings which are used for refinancing or reinvestment in the business. Nichter and Goldmark (2009) documented that in Kenya; most of the purchases of new machines among the microenterprises are primarily funded through the slow process of accumulating retained earnings. Akinyi (2014) warned that the fact that majority of the small scale businesses in relied retained earnings as one of the ways of financing their businesses besides other sources of internal financing, this was likely to impede their growth and hence negatively affecting their financial performance.

#### **2.4.5 Level of Education**

Kefale and Chinnan (2012) observed that micro enterprises having entrepreneurs or managers with higher formal education, work experience and training usually grow faster. This claim is seconded by Lemuel (2009) who noted that entrepreneurial education gives an effective and enduring strategy for solving the capital problems of small-scale businesses. Kimuyu and Omiti (2000) cited in Moyi (2013) found that level of education is one of the factors that significantly affected the demand for a loan among enterprises in Kenya. Mukiri (2008) noted that education is one of the

important resources that can lead to higher levels of entrepreneurial orientation. The study also indicates that formal education is thought to foster conformity and low tolerance for ambiguity and thus is an impediment to entrepreneurship. This means that education helps to distinguish entrepreneurs who access credit and those who do not (Lore, 2007). In this respect, education increases a person's stock of information and skills.

Kithae et al. (2013) examined the impact of entrepreneurship training on performance of Micro and small enterprises (MSEs) in Kenya. The purpose of this study was to examine the components of the entrepreneurship training program and their impact on performance of entrepreneurs. By using a sample population of 68 MSEs selected out of a target population of 1012 MSEs who received entrepreneurship training from Plan Eastern-Embu between the years 1995 and 2004 using systematic random sampling technique, the study found out that entrepreneurship training was as a substantial impact on performance of entrepreneurs. However, the study found out that some of the entrepreneurs do not fully translating their learnt skills into desirable business results due to inadequate finances and lack of monitoring to ensure that they appropriately apply their acquired skills. The study recommended that trainees should be closely monitored after training so as to ensure they are properly making use of the learning skills, and that financial assistance should be provided to trained beneficiaries for this will give them opportunities to start business and hence make use of the learnt skills.

Wekesa, Muthike, Githiomi and Muga (2012) carried out an overview of wood carvings industry developments in Kenya. The study aimed at synthesizing information on production and marketing of the woodcarvings. The study realized that the market access strategies applied include cooperatives, direct marketing, collective action, contractual arrangements and e-commerce. Besides, it was also realized that collective action including cooperatives and self-help groups is highly applied to market products. It was also noted that cooperatives are preferred due to their associated benefits in terms of higher site prices hence more profits as a result of bulk marketing. Self-help groups are small associations and are increasingly being preferred as an alternative to cooperatives. Contractual arrangements were observed

to be beneficial in that they result into income stability and improved efficiency besides benefiting producers through provision of technical advice, managerial expertise, market knowledge, and access to technological advances, such as high-quality carving, not otherwise available. It was also observed that E-commerce is the least applied although it leads to reduced transaction costs and improved information flow. The study recommended that there is need for concerted efforts in terms of technical capacity building for actors in the woodcarvings value chain to apply effective and efficient production and marketing technologies and innovations.

Muga et al. (2014) studied on classification of Kenyan wood carving species using macroscopic and microscopic properties. The main objective of the study was to determine physical, macroscopic and microscopic features of Kenyan wood carving species and use these properties to classify them. Samples for 52 wood carving species (including the potential alternative species) were obtained from Coast, Eastern and Nairobi regions. The results revealed that some of the salient macroscopic features important for wood carving species are: heartwood darker than sapwood, non-irritating odour, minute pores and rays, fine to medium wood texture, straight grains and distinct growth rings. High wood density is also found to be an important feature and about 80% of the species have densities ranging between 0.60 g/cm<sup>3</sup> to 1.23 g/cm<sup>3</sup>. The study also revealed that most of the woods carving species are moderately hard to very hard (4 to 20KN). The important microscopic features revealed from the study were: minute rays (1-3 cells wide), pores solitary or in radial multiples of 2 or more, vessels with simple perforations, very thick walled fibres and few parenchyma cells.

Mutinda (2014) was interested in assessing the impact of the woodcarving industry on the environment. The study aimed to examine the extent to which the practice has impacted on the raw materials used in the production of the craft. A sample of 100 woodcarvers participated in the survey. The study revealed that woodcarving is a source of livelihood for many families although the activity was observed to be practiced to the detriment of the environment. The study reiterated that there was a complete disappearance of some indigenous trees originally used in the industry due to inactive foresight in replenishing the resource base. It was also realized that NGOs

have very little to do with the handicraft industries despite the significance of the crafts as major income earners. The study suggested the need for woodcarvers to carry out their trade in a sustainable way and also carry out afforestation and reforestation programmes.

## **2.5 Research Gap**

From the above literature review, it is evident that the only few studies have been done on micro enterprises in Kenya, among them being Wanjohi (2010) which was on the challenges facing SMEs in Kenya and the efforts in progress, Nyanamba et al. (2013) which was interested in the factors that determine the capital structure among micro-enterprises, Mairura (2013) which looked at the effect of financial intermediation in the growth of the small and medium manufacturing enterprises in Nairobi, Njeru (2013) which was on the determinants of choice of source of entrepreneurial finance for small and medium sized enterprises, and Memba (2011) which sought to establish the impact of venture capital finance on performance of small and micro enterprises in Kenya. None of these researches attempted to address the effects of capital structure on financial performance of craft micro enterprises in Kenya. The only study that has been done that is close to the current study is Obwori et al. (2012) which concentrated on the effect of funding constraints on the growth of small scale enterprises in soapstone industry of Kenya, had no focus on the effects of capital structure on soapstone micro enterprises. It is for this reason that this research is undertaken so as to bridge the gap.

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

#### **3.1 Introduction**

This chapter shows the methodology used in the study to collect the relevant data and analyze it. It comprises the research design, target population, sampling frame from which the sample was chosen, sample size that was used in the study, sampling technique used and data collection instruments which were used in the study. Besides, the chapter also discusses the pilot testing which was done on the research instrument so as to determine their validity and reliability, and the data analysis.

#### **3.2 Research Philosophy**

Salminen (2013) stated that a researcher must acknowledge the approach for solving and answering research questions through a research philosophy, and that this research philosophy guides the researcher throughout the study in exercising the basic function of science; obtaining new relevant scientific knowledge. Saunders et al. (2009) define research philosophy as an overarching term relating to the development of knowledge and the nature of that knowledge in relation to research. To meet the predetermined objectives, the study used positivism research philosophy. This research philosophy is an epistemological position that involves working with an observable social reality. In positivist approach, the researcher has no powers to alter the information obtained from the data collection instrument. In a nutshell therefore, the researcher just reports what was observed in the field. It is for this reason that the philosophy deemed fit for the study.

#### **3.3 Research Design**

Njeru (2013) pointed out that the function of research design is to ensure that the evidence obtained enables the study to answer the research questions as unambiguously as possible. This study adopted descriptive research design. This design deemed appropriate in testing the relationship between the different components of independent variables (internal equity finance, debt financing and

retained earnings) and dependent variable (financial performance of craft microenterprises) of this study. This research designs had been found useful in previous related studies.

### **3.4 Target Population**

The target population for the study constituted all the soapstone micro enterprises in Tabaka Town which are registered by Tabaka Town Council, Kisii County, and all the woodcarving micro enterprises of Wamunyu Location, Machakos County, which are registered by Wote Town Council. The accessible population was all the soapstone micro enterprises that were operating within Tabaka Town and all the woodcarving micro enterprises that were operating within Wamunyu Location. The soapstone micro enterprises in Tabaka Town carry out various businesses associated with soapstone ranging from mining, owning quarries, marketing of the products themselves both locally and overseas (Obwori et al., 2012), while the woodcarving micro enterprises in Wamunyu Location are engaged in ownership of wood species for carving, carving of wood and marketing of carved products. There are 1,134 soapstone micro enterprises were operating within Tabaka Town (Kisii County Ministry of Trade and Industry, 2014) and 1200 registered carving micro enterprises within Wamunyu Location (Machakos County Ministry of Trade and Industry, 2014). The study gathered information from these two locations (Tabaka Town and Wamunyu Location) because the carvings are carried out in the locality where the resources are found. Besides, the micro enterprises who engage in this business activity in the other parts of the country mainly undertake it as middlemen.

### **3.5 Sampling Frame**

A sampling frame has the property that the researcher can use to identify every single element and include in the sample (Saunders et al., 2007 as cited in Njeru, 2013). The sample frame for this study constituted all the 1,134 soapstone micro enterprises which are currently operating within Tabaka town and 1200 registered carving micro enterprises within Wamunyu location.

### 3.6 Sample Size and Sampling Technique

This study used both probability sampling and non-probability sampling methods in order to gather the necessary data for analysis. The study employed stratified sampling and simple random sampling techniques as probability sampling techniques; and purposive sampling technique, which is a non-probability sampling method, to obtain data from the soapstone micro enterprises within Tabaka Town and woodcarving micro enterprises in Wamunyu Location. The study grouped the micro enterprises into two strata based on region, and then each stratum was stratified further according to the activities which the craft micro enterprise is engaged in, and then a sample was randomly selected from each stratum. Purposive sampling was used to distinguish craft micro enterprises from small, medium and large craft enterprises. The researcher requested for lists of craft micro enterprises that are registered by issue of business license, by Tabaka Town Council and Wote Town Council, which were used to identify the relevant craft micro enterprises to be used in the study. This is with an assumption that all the craft micro enterprises currently in operation are registered. The sample of 330 respondents was divided proportionately between the two regions according to the proportion of their craft micro enterprises under study as follows:

Sample size for Tabaka Town =160 respondents

Sample size for Wamuyyu Location =170 respondents

For each region, each stratum was allocated a sample size proportional to the size of its sample by taking the population of the stratum divide by the total number of craft micro enterprises of the region then multiplied by the sample. For instance, the sample to be picked from the quarry owners in Tabaka Town was given by:

$$\text{Sample size} = \frac{94}{1134} \times 160 = 13 \text{ respondents}$$

The sample size from the owners of wood species was be given by:

$$\text{Sample size} = \frac{363}{1200} \times 170 = 51 \text{ respondents}$$

The remaining sample sizes for the remaining strata were calculated in similar manner. This yielded sample sizes as shown in table 3.1 and table 3.2 below:

**Table 3.1: Summary of Sample of Respondents in Tabaka Town**

Stratum	Population	Sample Size
Quarry owners	94	13
Miners	143	20
Carvers	449	64
Finishers	201	28
Retailers	187	26
Wholesalers	60	9
<b>Total</b>	<b>1134</b>	<b>160</b>

**Table 3.2: Summary of Sample of Respondents in Wamunyu Location**

Stratum	Population	Sample Size
Owners of wood species	363	51
Carvers	372	53
Finishers	162	23
Retailers	269	38
Wholesalers	34	5
<b>Total</b>	<b>1200</b>	<b>170</b>



Mugenda and Mugenda (2003) opine that the sample size for a population of 10,000 or more can be computed using the formula shown below:

$$n = \frac{pqz^2}{e^2}, \text{ Where}$$

$n$ = minimum sample size

$p$ =population proportion with given characteristic

$q=1-p$

$z$ =standard normal deviate at the required level of

confidence

$e$ =error margin

Mugenda and Mugenda (2003) further add that if  $p$  and  $q$  are unknown, then both can be set at 50%. Since the study adopted a confidence level of 95%, meaning that  $z=1.96$  and the sampling error of  $\pm 0.05$ , the sample size for this study was calculated as follows:

$$n = \frac{(0.50)(0.50)(1.96)^2}{(0.050)^2}$$
$$=384$$

Since the target population was less than 10,000 the sample size was determined as shown below:

$$n_f = \frac{n}{1 + \frac{n}{N}}$$

$$= \frac{384}{1 + \frac{384}{2554}}$$

$$= 329.75$$

This means that the study used a sample of 330 craft micro enterprises. The formula was adopted for use in calculation for the sample because other related studies had found relevance in using it (Obwori et al., 2012; Njeru, 2013).

### **3.7 Data Collection Instruments**

The study gathered data using a semi-structured questionnaire. A questionnaire was made up of a series of set questions, and either provided a space for the answer or offered a number of fixed alternatives from which the respondent makes a choice. The questionnaire contained both open-ended and closed-ended questions. Open-ended questions are important when there are too many possible responses to a question, when the researcher does not want to impose response categories to respondents, when the researcher wishes to provide a qualitative dimension to the study (Jackson, 2002). The study opted to use a structured questionnaires because it can be kept for future reference if need be. The study also gathered secondary data from the respondents' books of accounts. This was with an aim to expose into details the craft micro enterprises' financing and profitability status over the preceding three years.

The researcher in conjunction with one research assistant delivered the questionnaire to the respondents who were required to fill and return immediately. However, in a situation where the respondent required more time to fill it, the questionnaire was left with the respondent after the researcher had recorded the respondent's contacts so as

to ease location of the questionnaire after three days. As for those respondents who are unable to fill the questionnaire due to one reason or the other, the researcher or research assistant used the interview schedule to gather information and then record it down accurately. By doing this, it was hoped that the research would achieve a neighborhood of 100% response rate.

### **3.8 Pilot Testing**

In order to ascertain the reliability of the questionnaires, the researcher conducted a pilot study on the questionnaires by administering it to some respondents who would not be sampled for the real research. Pilot testing helped the researcher detect any anomalies which could be in the questionnaire so that they are corrected before the real data collection exercise. Lancaster, Campbell, Eldridge, Farrin, Marchant, Muller and Rait (2010) asserted that, in order to achieve high precision pilot studies, 1% to 5% of the sample should constitute the pilot test size. For this reason therefore, the study used a sample of 33 respondents (representing 1% of the sample) of whom 17 were drawn from Wamunyu Location while 16 were from Tabaka Town.

### **3.9 Reliability and Validity of the Instruments**

#### **3.9.1 Reliability**

Reliability is the consistency of your measurement, or the degree to which an instrument measures the same way each time it is used under the same condition with the same subjects. A measure is considered reliable if a person's score on the same test given twice is similar (Ngugi, 2013). An instrument cannot be valid unless it is reliable. To ensure reliability, the researcher calculated the Cronbach Alpha Coefficient using the results of the piloted questionnaire. Cronbach Alpha is used as a measure of the internal consistency of items in the questionnaire.

### 3.9.2 Validity

Validity refers to the strength of our conclusions, inferences or propositions (Ngugi, 2013). To ensure validity, the researcher consulted the university supervisors who proof read the questionnaire and guided on any adjustments that may be required.

### 3.10 Data Analysis

The data collected were first edited, coded, tabulated, then analyzed by use of descriptive and inferential type of statistics using the Statistical Package for Social Science (SPSS) version 21. Qualitative data were analyzed by use of descriptive statistics which involved calculation of frequencies and percentages; while quantitative data were analyzed by use of inferential statistics which involved the use of Analysis of Variance (ANOVA). Besides, multiple regression analysis was done by regressing the financial performance of craft micro enterprises against internal equity financing, debt financing and retained earnings. The study developed a financial performance model from the variables which were perceived to determine the financial performance of craft micro enterprise. The financial performance model for craft micro enterprises was presented as follows:

$$PERF = \beta_0 + \beta_1 IE + \beta_2 DF + \beta_3 RE + Z(\beta_1 IE + \beta_2 DF + \beta_3 RE), \text{ where,}$$

**PERF**= financial performance of Craft Micro Enterprise

**$\beta_0$** =Coefficient of Intercept

**IE**=Internal Equity Financing

**DF**=Debt Financing

**RE**=Retained Earning

**LE**=Level of Education

$\beta_1, \beta_2$  and  $\beta_3$ =regression coefficient of four independent variables

$\epsilon$ =error term

The study carried out diagnostic tests so as to determine the suitability of the collected data in making conclusions about the population. Specifically, the study employed Cronbach's Alpha to determine the reliability of the constructs (internal equity financing, debt financing, retained earnings and level of education). Test on normality for each of the constructs was done using Shapiro-Wilk test, while the Park test was run to test for heteroscedasticity. Pearson's correlations were used to gauge correlations between the study variables.

All the hypotheses were tested using the student's t-test. Besides, the study also used analysis of variance (ANOVA) to test the significance of the overall model at 95% level of significance. The choice of the above types of inferential statistics was based on the fact that previous related studies had used them and found them effective (Ngugi, 2013; Thirumalaisamy, 2013; Moyi, 2013; Obwori et al., 2012; Ahmad et al., 2012; Sekyewa, 2009). The results were then summarized in tables, charts and graphs.

## CHAPTER FOUR

### RESEARCH FINDINGS AND DISCUSSIONS

#### 4.1 Introduction

The study investigated the influence of capital structure on financial performance of craft micro enterprises in Kenya. Specifically, the study sought to determine the influence of internal equity financing, debt financing and retained earnings on financial performance of craft micro enterprises in Kenya, besides establishing the moderating influence of level of education on the relationship between capital structure and financial performance of craft micro enterprises in Kenya.

#### 4.2 Response Rate

The study sought to address the objectives by administering a questionnaire to respondents and analyzing it. Out of the 330 respondents to whom the questionnaire was administered, 274 respondents filled and returned the questionnaires to the researcher. This represented 83.03% response rate and this was considered sufficient enough from which to draw conclusions upon. Mugenda and Mugenda (2003) declares 50% and above response rate as being satisfactory to use in inferring upon. The study considers a 50% response rate as adequate, 60% and above as good, while 70% and above is rated very good. Similar sentiments are shared by Babbie (2010) asserted that return rates of above 50% are acceptable to analyze and publish, 60% is good and 70% is very good. This means that the response rate for this study was very good.

#### 4.3 Reliability Analysis

The reliability of the questionnaire was determined by calculating the Cronbach Alpha coefficient. As Ngugi (2013) pointed out, Cronbach's alpha estimates internal consistency by determining how all items on a test relate to all other items and to the total test and it is expressed as a coefficient between 0 and 1.00, with a higher the coefficient indicating a more reliable test. The value of Cronbach Alpha for each of the constructs was as presented in table 4.1.

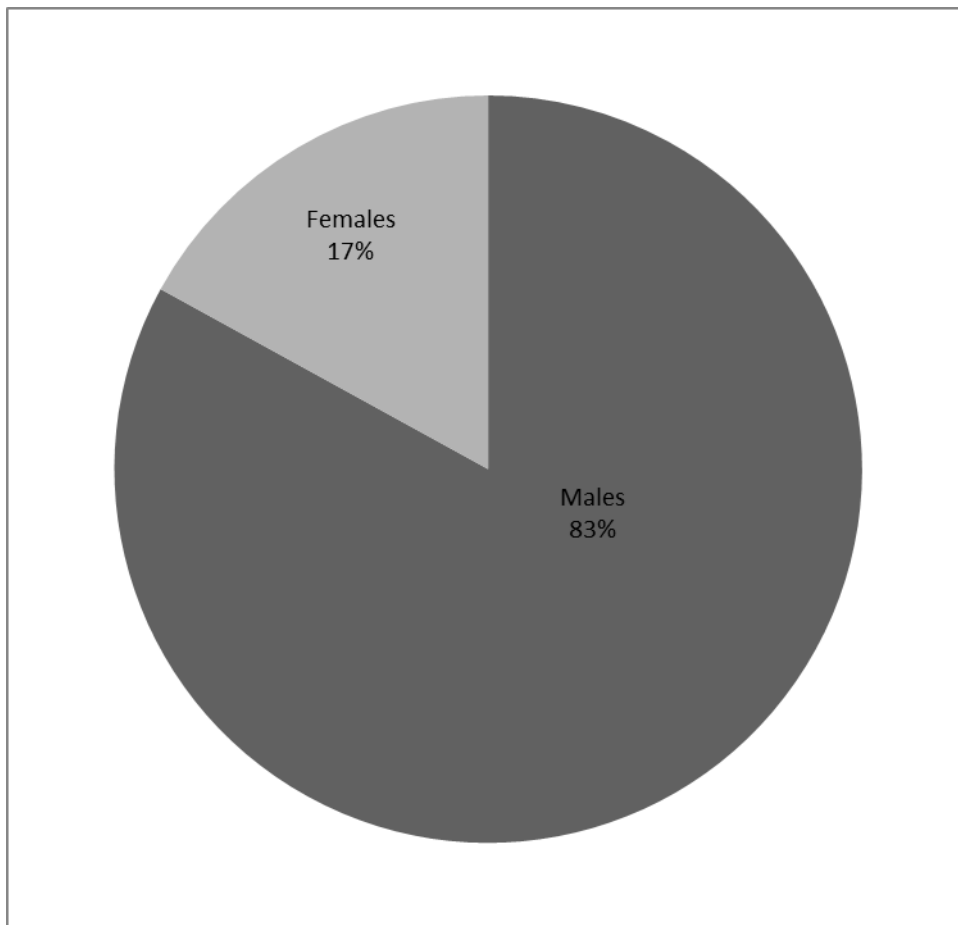
**Table 4.1: Reliability Test of Constructs**

<b>Financial Performance</b>	<b>Cronbach's Alpha</b>
Internal Equity Financing	0.811
Debt Financing	0.779
Retained Earnings	0.826
Level of education	0.842

The results in table 4.1 shows that, internal equity financing had a Cronbach Alpha coefficient of 0.811, debt financing had a Cronbach Alpha coefficient of 0.779, retained earnings had a Cronbach Alpha coefficient of 0.826 while level of education had a Cronbach Alpha coefficient of 0.842. This implies that all the constructs under study had a Cronbach Alpha coefficient greater than 0.5, implying that all the constructs were reliable to use in collecting the needed data. The use of this test was prompted with the fact that several other previous studies had adopted it in their determination of reliability and, upon obtaining a value greater than 0.5, they declared their constructs as being reliable (Wire, 2015; Kibet et al., 2015; Kimani, 2015; Memba, 2011).

#### **4.4 Gender of Respondents**

The study wanted to know the distribution by gender, of the respondents involved in the study. This was with a view to determine whether both genders are well presented in the craft microenterprises industry. The findings revealed the following results in figure 4.1:



**Figure 4.1: Gender of Respondents**

The findings in figure 4.1 revealed that gender of craft micro entrepreneurs is unfairly skewed in favour of men in the sense that 83% of the respondents were males while only 17% of the respondents were females. This finding implies that the industry is dominated by males. This could be due to the fact that traditionally, carving was a male activity and hence most women see it as a preserve of men to date. The profession is also labour intensive and this could further scare away females who would want to venture in it.

Similar findings in gender imbalance had been observed in previous studies. For instance, Obwori et al. (2012) whose study found out that, small scale enterprises in soapstone industry were dominated by males who constituted 61% against 39% females; and attributed this to male dominance accompanied by the cultural notion that soapstone carving was a reserve of men. Njuguna (2015) on the factors affecting



effective participation of micro and small enterprises in public procurement in Kenya also noted that 58.6% of the enterprise owners constituted males, 38.7% were females while 2.7% failed to disclose their gender. Paul (2014) on the role of entrepreneurial leadership in the growth of MSEs also found out that 62% of the respondents were males while 38% of the respondents were females. Kibet et al. (2015) realized that 75% of entrepreneurs constituted females while only 25% of the entrepreneurs were males. However, the study findings differ with Kibet et al. (2015) whose study found out that 48.9% of the respondents were males while 51.1% of the respondents were females; and that of Wanambisi and Bwisa (2013) who obtained 50% response from each gender.

#### 4.5 Respondents' Age

The study sought to know the distribution by age, of the respondents involved in the study. The study yielded the results in table 4.2.

**Table 4.2: Respondents' Age**

Age	Frequency	Percentage
Below 18 years	21	7.7
between 18 and 35 years	65	23.7
between 36 and 45 years	149	54.4
between 46 and 55 years	37	13.5
over 55 years	2	0.7
<b>Total</b>	<b>274</b>	<b>100.0</b>

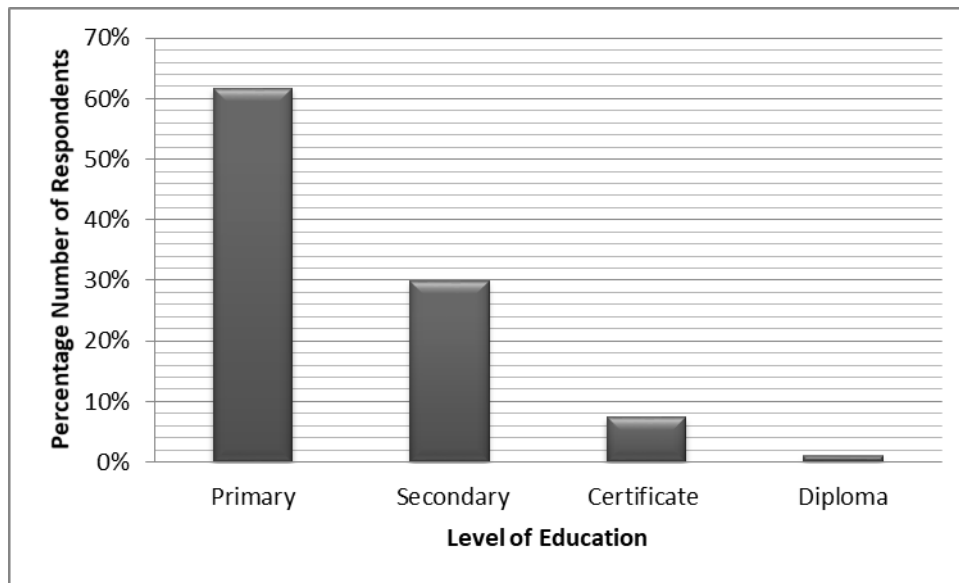
As table 4.2 summarizes, the study revealed that 7.7% of the respondents were below 18 years old; 23.7% of the respondents were aged between 18 and 35 years old, 54.4% of the respondents were aged between 36 and 45 years old, 13.5% of the respondents were aged between 46 and 55 years while only 0.7% of the respondents were over 55 years old. This implies that majority of the respondents are of the age between 18 years and 45 years. The fact that there were few respondents of the age

below 18 years indicates that the profession does not attract under-age persons. It could also be due to the free primary education that has seen most pupils who would have otherwise dropped out of school continue with their education. The study also noted a small percentage of respondents who were over 55 years of age probably because most of the enterprises under study were labour intensive thus the aged could not easily cope.

This finding supports Mutinda's (2014) study which observed that majority (43%) of the people in the wood carving industry at Wamunyu were between 17 and 30 years of age; 21% of them were between 31 and 40 years old; 17% of them were of age between 41 and 50 years of age while only 8% of them were over 50 years of age. Ngugi (2013) also noted that 88.5% of the entrepreneurs were 45 years and below, and this is identical to the findings of this study. The findings almost concur with Paul (2014) who noted that 48% of the entrepreneurs were aged between 16 and 35 years; 46% were aged between 36 years and 50 years while only 6% were over 50 years old. The deviation in percentage between their findings and this study was due to the fact that the ages were split into differing age brackets in the studies relative to this study.

#### **4.6 Level of Education**

The research sought to know the highest level of education that respondents had attained before joining the carving industry. This was aimed at determining whether the respondents had knowledge that can help them in running the business. The findings were as shown in figure 4.2.



**Figure 4.2: Level of Education**

Figure 4.2 shows that 169 (61.7%) respondents had primary level of education, 82 (29.9%) respondents had attained secondary level of education while 21 (7.4%) respondents had Certificate level of education and only 2 (1%) respondents had Diploma level of education. This means that majority (91.6%) of the respondents had at most Secondary education as their highest level of education. This means that, the majority of the respondents have basic education which is not enough to enable them manage businesses effectively.

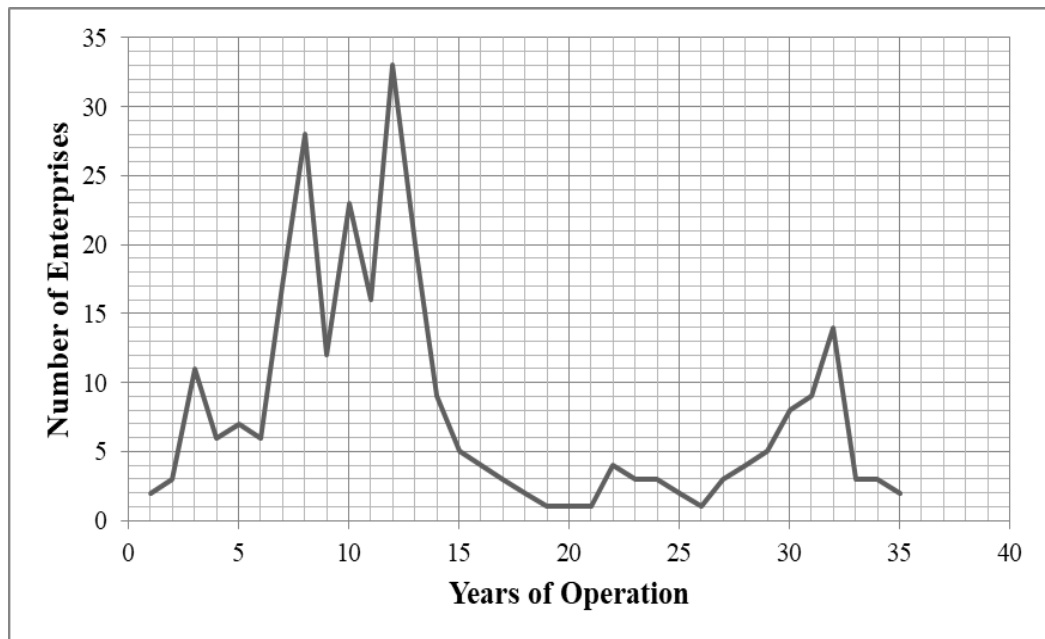
This study collaborates with several other previous studies. For instance, Kamunge et al. (2014) indicated that 93.5% of the respondents had at most secondary school level of education. Mutegi, Njeru and Nyamboga (2015) which noted that 86% entrepreneurs had secondary level of education and below, while Mutinda's (2014) study which documented that majority (91.7%) of those engaged in the wood carving industry had at most secondary level of education.

However, the findings of the study seemed in disharmony with the findings Wanambisi and Bwisa (2013) who reported that only 50% of the respondents had secondary level of education and below; and that of Ruhui (2015) who found out that

only 0.8% of the incubation entrepreneurs had at most secondary level of education; and this could be due to the fact that incubation is a type of business that requires a lot of formal training, implying that most of the entrepreneurs must have attended tertiary education so as to acquire the knowledge. Ngugi (2013) recognized the importance of education by stating that it influences the performance of enterprises.

#### 4.7 Years of Operation of Enterprises

The study sought to know the year in which the enterprises were established. This was with a view to determine the number of years the enterprises have been in operation. The respondents gave their views as shown in figure 4.3.



**Figure 4.3: Enterprise's Years of Operation**

Figure 4.3 shows that majority of the craft enterprises had been in operation between 5 years and 15 years and, to some extent, between 29 years and 32 years. These could be the periods when the industry was facing a boom hence motivating more people to join the industry. These findings concur with Kyalo (2013) whose study revealed that 90.3% of the enterprises were established between 5 and 15 years ago. Lucimbo (2016) observed that almost half (45.8%) of enterprises had been in existence for 6-15 years while 41.6% of the enterprises were less than 5 years old. However, the

study differs with that of Odero-Wanga et al. (2013) who realized that 73.2% of enterprises had not been there for more than 3 years; and that of Njuguna (2015) who posted that majority (42.53%) of the enterprises had been in existence for 1-2 years, followed by 22.6% which had been in existence for a few months.

#### **4.8 Current Amount Financing for Enterprises**

The study wanted to know the current amount of financing for the microenterprises involved in the study. The findings were as presented in table 4.3.

**Table 4.3: Current Amount of Financing**

<b>Amount</b>	<b>Frequency</b>	<b>Percentage</b>
Less than 20,000	228	83.2
20,001-40,000	8	2.9
40,001-60,000	13	4.7
60,001-80,000	3	1.1
80,001-100,000	9	3.3
Over 100,000	13	4.7
<b>Total</b>	<b>274</b>	<b>100.0</b>

The results displayed in table 4.3 shows that 83.2% of the respondents had financing of less than Ksh. 20,000 while another 2.9% of respondents had financing ranging Ksh. 20,001-40,000. The respondents who had secured financing in the range Ksh. 40,001-60,000 was 4.7% while only 1.1% of the microenterprises had funding ranging Ksh. 60,000-80,000 and another group of 3.3% of respondents had financed their microenterprises with funds ranging Ksh. 80,001-100,000 with the remaining 4.7% of the respondents funding their microenterprises with funds of over Ksh. 100,000. The finding shows low amount of financing probably because the enterprises get low income from the businesses or because their enterprises required little capital, as in the case of carvers and finishers. Mwirigi (2011) attested that 84%

of enterprises financing of Ksh. 10,000 or less. However, the findings differed with those observed by Kefale and Chinnan (2012) who realized that 72.9% of micro enterprises in Ethiopia were started with capitalization of 20,000 Birr (equivalent to approximately Ksh. 91,400 at an exchange rate of 1Birr=Ksh. 4.57) with the average capital being 7431Birr (approximately Kh. 33,960) while small enterprises had an average capital of 53155.45 Birr (approximately Ksh. 242,920).

#### 4.9 Enterprise' Sources of Internal Finance

The study wanted to know the various internal sources from which the craft microenterprises got their finance. This was with a view to establish the most preferred form of internal equity financing for the craft microenterprises. For this reason, a list of selected sources of internal equity finance was provided and respondents were asked to identify the sources from which they had got financing. The respondents' views were as presented in table 4.4.

**Table 4.4: Source of Internal Finance**

Source of Financing	Frequency	Percentage
Profits	249	90.9
Sale of assets	40	14.6
Savings from reduced capital	3	1.1
Personal saving	10	3.6

The findings in table 4.4 show that, the major source of finance was profits from which 90.9% of the respondents had sought financing. This was followed by sale of assets which provided finance to 14.6% of the enterprises, 1.1% of enterprises which sought finance from savings from reduced capital, while only 3.6% of enterprises had sourced finance from personal savings. There could be many reasons why most of the funding was from profits. First, this is the easiest internal source of equity financing. Secondly, this could be due to the entrepreneur's inability to raise collateral so as to use in securing loan from financial institutions. Thirdly, it could be due to the entrepreneurs' fear of inability to repay the loan. Fourthly, it could be due to the fact that most of the businesses do not require so much capital to warrant

external financing. This is so because most of the enterprises studied were service-providing. The reason why the respondents couldn't use personal savings a source for finance could be a further indication of the low economic status of the entrepreneurs. For instance, residents of Wamunyu Location are affected by drought most of the time in a year and hence they mostly rely on relief food supply almost on permanent basis (Mutinda, 2014). The entrepreneurs could also be relying on profits as a source of finance because it is the cheapest source of financing and that they do not have other sources of income (Mutinda, 2014).

These study findings differ from Osie-Assibey (2010) who realized that the main source of start-up capital for 69.3% of the micro enterprises was from personal saving; and Lemuel (2009) who documented that 70% of enterprises in Nigeria had their capitalization from own funds and retained earnings while 4% of the enterprises used capital borrowed from family, friends and other informal sources. However, the study resonates with Kibet et al. (2015) whose study revealed that only 12.8% of the small businesses in got their initial capital financing from personal savings; and that of Ruhui (2015) which disclosed that 57% of respondents agreed that own source of financing is very important for any business.

#### **4.10 Amount of Funding from Individual Internal Sources of Finance**

The study sought to determine the breakdown of funding from each of the internal sources of finance from which the respondents had sought internal sources of finance. This was with a view to ascertain whether the funding obtained was substantive to boost capital in the respective businesses. The results were as indicated on table 4.5.

**Table 4.5: Funding from Individual Internal Sources of Finance**

<b>Source of Finance</b>	<b>Amount (Ksh.)</b>	<b>No. of Respondents</b>	<b>Percentage</b>
Profit	Less than 20,000	244	98.0
	20,001-40,000	2	0.8
	40,001-60,000	1	0.4
	60,001.80,000	1	0.4
	80,001-100,000	1	0.4
Sale of assets	Less than 20,000	36	90.0
	20,001-40,000	4	10.0
	40,001-60,000	0	0
	60,001.80,000	0	0
	80,001-100,000	0	0
Savings from reduced capital	Less than 20,000	3	100.0
	20,001-40,000	0	0
	40,001-60,000	0	0
	60,001.80,000	0	0
	80,001-100,000	0	0
Personal savings	Less than 20,000	10	100.0
	20,001-40,000	0	0
	40,001-60,000	0	0
	60,001.80,000	0	0
	80,001-100,000	0	0

As table 4.5 illustrates, the results showed that 98% of those who had used profits as a source of finance injected at most sh. 20,000 into the business while 0.8% of respondents injected between sh. 20,001-40,000 into the business. The study further indicated that 0.4% respondents injected between sh. 40,001-60,000 while 0.4% of respondents boosted their businesses with between sh. 801,001-100,000. This shows that, although majority of respondents used profits as the main internal source of finance, the amount injected was not substantial as to cause positive impact on the business.



As far as the sale of assets as a source of internal finance is concerned, the study found out that 90% of those who had used it as their internal source of finance submitted not more than sh. 20,000 to their business while 10% of them injected sh. 20,001-40,000 to their business. The study further realized that all (100%) of the respondents that had used savings from reduced capital injected at most sh. 20,000 into their businesses. Similarly, all (100%) respondents that had used personal savings as their internal source of finance did not commit more than sh. 20,000 into their business. These findings reveal that the latter three internal sources of finance (sale of assets, savings from reduced capital and personal savings) were not preferred so much as source of providing additional capital to enterprises. This could be due to the fact that most entrepreneurs do not have assets that they can dispose so as to inject the proceeds to their business, their net profits are sufficient to supply their businesses with additional capital when needed, or that they are contented with their current capitalization. This finding complies with the POT which states that firms first prefer financing with funds generated within the business, for instance, profits and retained earnings since these do not dilute ownership. The study is also in support of Mutinda (2014) whose study revealed that most craft entrepreneurs of Wamunyu Location preferred profits as a source of finance because it is the cheapest source of financing and that they do not have other sources of income.

#### **4.11 Average Internal Equity Financing**

The research wanted to know the average internal equity financing from the various sources under study. The study yielded the following results in table 4.6:

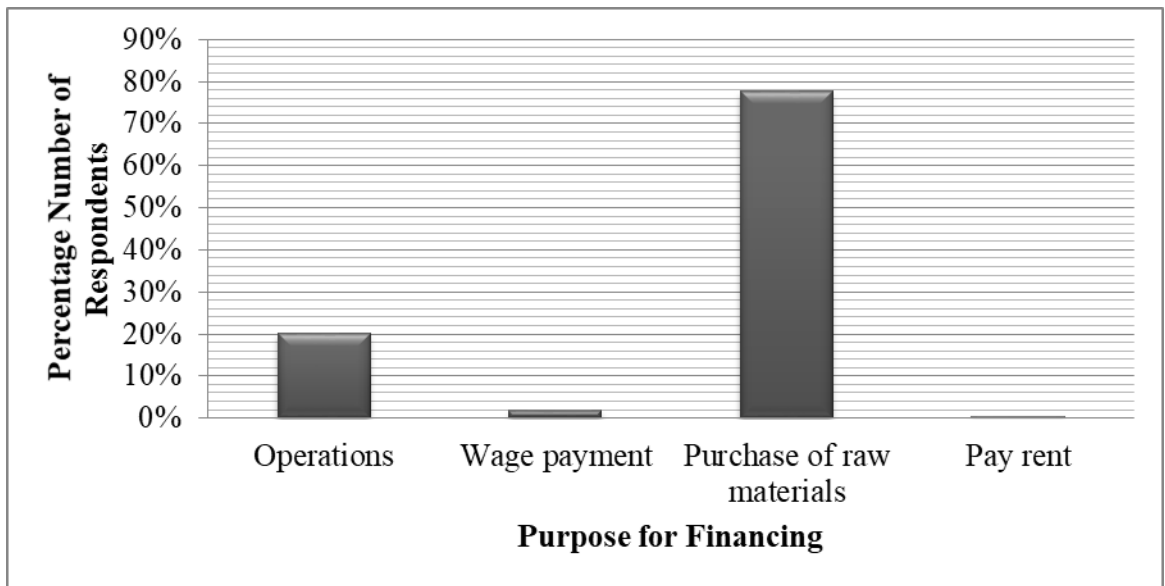
**Table 4.6: Average Equity Financing**

	<b>N</b>	<b>Minimum</b>	<b>Maximum</b>	<b>Mean</b>	<b>Std. Deviation</b>
Profits	274	.00	100000.00	16824.3	5902.54
Sale of Assets	274	.00	40000.00	8368.41	1243.02
Reduced Capital	274	.00	10000.00	7133.33	1430.04
Personal Savings	274	.00	200000.00	12360.04	2429.05

The results in table 4.6 indicates that; profits were the major source of internal finance from which respondents sought an average of Ksh.16824 with a standard deviation of Ksh. 5902. This was followed by personal savings from which the respondents had sought an average of Ksh. 12,360 with a standard deviation of Ksh.2,429. The study also found out that the respondents used an average of Sh. 8368.41 from the sale of assets and an average of Ksh. 7,133.3 from reduced capital. This study supports Osie-Assibey (2010) who stated that the most (69.3%) of the micro enterprises used own savings to finance their businesses; and Lemuel (2009) who documented that 70% of Nigerian enterprises used own funds to finance their businesses. The findings of Ruhui (2015) disclosed that 57% of respondents agreed that own source of financing is very important for any business. These findings also contradict Memba's (2011) study which observed that SMEs in Kenya used venture capital as one of their forms of external financing and that this made the SMEs to experience growth, improvement in financial management, use of better management approach besides enabling them attract more finance from other sources including the banking industry. This leads to the conclusion that, although venture capital is utilized in the SMEs in other sectors, the craft microenterprises sector has not embraced this form of financing, and this could probably be due to the nature of the respondents in this study, majority of whom were service providers.

#### **4.12 Reasons for Seeking Internal Financing**

Respondents were asked to indicate the purpose for which the internal sources of finance were needed. The findings were as indicated in figure 4.4:

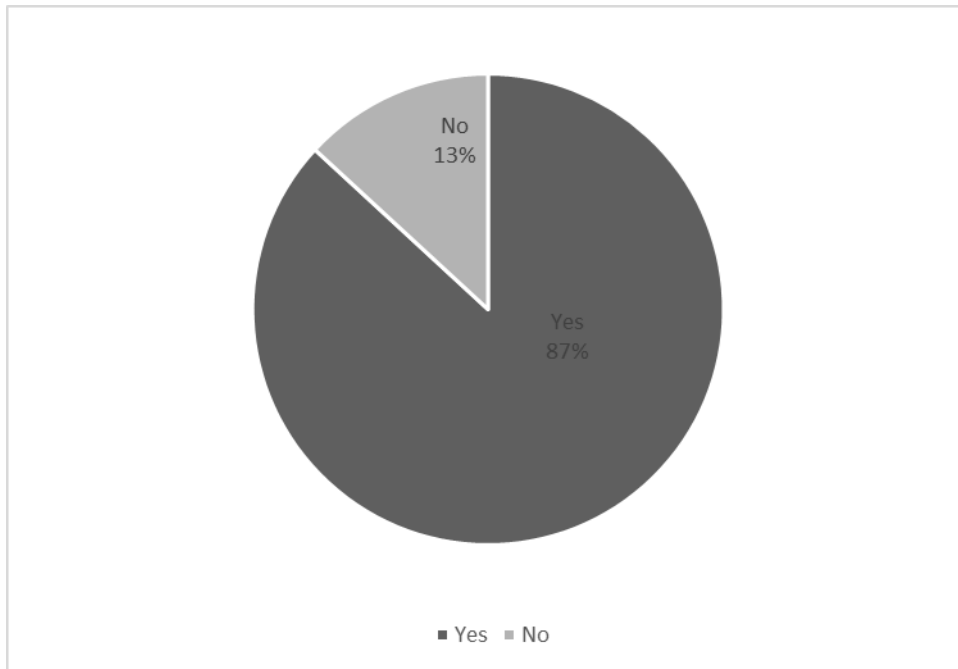


**Figure 4.4: Need for Internal Finance**

Figure 4.4 shows that that the enterprises needed internal finances mainly purchase raw materials (77.7% respondents), operations (20.1% respondents) while 1.8% of respondents used internal funds to finance wage payment. The study further realized that only 0.4% of respondents used internal sources of funds to pay rent. The raw materials in which the financing was used is purchase of the soapstone for carving, sand papers and the paints for giving the sculpture a finishing touch. The study observed that only a small percentage of financing was utilized to pay rent probably because most enterprises are done in the quarries sites or from the entrepreneurs' home residence. These findings concur with Obwori et al. (2012) which found out that 88% of the loan advanced to entrepreneurs was used to expand business while only 3% of the loans were used to pay debts. Ruhui (2015) also obtained similar results that 48% of funding was utilized towards purchase of capital goods.

#### **4.13 Enterprises' Need for Debt Financing**

The study sought to establish whether the enterprises had borrowed money from financial institutions at some point in time. This was deemed necessary since it portrays the business' need to expand. The results were as indicated in figure 4.5:



**Figure 4.5: Enterprises' Need for Debt Financing**

From figure 4.5, the research realized that 87% of the respondents had borrowed from financial institutions at some point while only 13% of the respondents had not sought for financing from financial institutions at any given time. The reason why the respondents had sought financing from financial institutions could be due to their inability to raise sufficient capital from their net income since, as observed by Obwori et al. (2012), the net income from the craft microenterprises was mainly used to support non-business activities like family upkeep. It could also be because of the need for business expansion. This study supports that of Dube (2013) which realized that 75% of small businesses in Zimbabwe had shown the need for financing; and this was achieved through debt financing. The finding underscores those of Wanambisi and Bwisa (2013) who stated that only 41.7% of the enterprises in Kitale Municipality had sought financing.

#### **4.14 Use of Debt Finance**

Respondents were asked to disclose the amount of finance they had used from debt financing. Some selected sources of finance were provided on a table and the

respondents were required to indicate the amount they had got from them. Table 4.7 below shows the findings.

**Table 4.7: Average Debt Financing**

	N	Minimum	Maximum	Mean	Std. Deviation
MFI loans	274	0	0	.00	.00
Commercial Bank loans	274	0	25000	22000	17888.54
SACCOs	274	0	30000	17000	12041.59
Development bank loans	274	0	0	.00	.00
Trade credit	274	0	0	.00	.00
Credit unions	274	0	0	.00	.00
Private placements	274	0	0	.00	.00
Small Business Investment Companies	274	0	0	.00	.00
Small Business Lending Companies	274	0	0	.00	.00
Valid N (listwise)	274				

The findings displayed in table 4.7 shows that Commercial Bank loans and SACCO loans were the only sources of debt financing from which the respondents had sourced some finance. The study further revealed that, on average, respondents borrowed Ksh. 22,000 and Ksh. 17,000 from the Commercial Banks and SACCOs respectively. This shows that Commercial Bank loans and SACCO loans are the only major sources of external finance for the craft micro enterprises, and majority of those who got funding were wholesalers and retailers who are thought to have collaterals.

These findings concur with those of Mukiri (2008) who had observed that the average annual amount of credit borrowed by micro entrepreneurs was Ksh. 62,500. Odero-Wanga et al. (2013) who noted that most women entrepreneurs in milk microenterprises did not acquire credit from formal financial institutions and instead 81% of them sourced their financial assistance from friends and relatives. However, the study differs with Kibet et al. (2015) whose study documented that 63.8% of enterprises in Uasin Gishu benefited from loans from MFIs while 17% obtained

loans from banks. Ahmad et al. (2012) realized that only short term debts ha an influence on the ROE of Malaysian enterprises. Njuguna (2015) stated that corruption was one of the reasons why some entrepreneurs were not able to secure loans, and this could be one of the reasons why entrepreneurs could only be able to secure loans from these two sources. In a study by Ongoro (2013), 97% of respondents agreed that loans are significant in improving the performance of an enterprise. Majority (70.2%) of respondents in a study by Kamunge et al. (2014) opined that access to finance was the greatest way to improve performance of an enterprise.

#### **4.15 Distribution of Borrowing from Commercial Bank loans**

The distribution of average borrowing from Commercial Bank loans was as indicated from table 4.8.

**Table 4.8: Average Borrowing from Commercial Bank loans**

<b>Amount</b>	<b>Frequency</b>	<b>Percentage</b>
Less than 20,000	269	98.2
20,001-40,000	3	1.0
40,001-60,000	1	.4
60,001-80,000	1	.4
80,001-100,000	0	.0
Over 100,000	0	.0
<b>Total</b>	<b>274</b>	<b>100.0</b>

The results shown in table 4.8 show that, only five firms borrowed over Ksh. 20,000 from Commercial Bank loans over the span of the three years (2013-2015). This may lead to a conclusion that majority of the firms in this study did not get any loan either because they did not have collateral, they feared rejection, they lacked guarantors or they did not meet the condition for group saving, and this confirms the study by Wanambisi and Bwisa (2013). The majority of the firms borrowed between Ksh. 20,001 and Ksh. 40,000. Ruhiu (2015) claimed that access to finance greatly influences the sales growth of any enterprise. Dube (2013) narrated that 75% of

enterprises in Zimbabwe had obtained debt financing and that, 81% of these had recorded increased productivity.

This study is in full support of Kadiri (2012) whose study concluded that enterprises in Nigeria do not get any financing from commercial banks in Nigeria, Mukiri (2008) who had observed that only 7.8% of micro entrepreneurs access bank credit annually, and Njuguna (2015) who reported that only 4.6% of entrepreneurs got funds from commercial banks. However, the study contradicts that of Mukiri (2008) who found out that most of those manufacturing enterprises in Nairobi that had borrowed took an average of Ksh. 62,500. This could be attributed to the fact that Mukiri's (2008) study looked at manufacturing enterprises while majority of respondents in this study are service providers. However, the findings oppose those of Wanambisi and Bwisa (2013) who found out that 41.7% of entrepreneurs had ever taken loans, and that majority of these had received between Ksh.50,000-100,000 while only 17% had received less than Ksh. 50,000 as loan, provided they had collaterals.

#### **4.16 Distribution of Borrowing from SACCOs**

The distribution of average borrowing from SACCOs was as indicated from table 4.9.

**Table 4.9: Average Borrowing from SACCOs**

<b>Amount</b>	<b>Frequency</b>	<b>Percentage</b>
Less than 20,000	269	97.1
20,001-40,000	3	1.1
40,001-60,000	2	.7
60,001-80,000	3	1.1
80,001-100,000	0	.0
Over 100,000	0	.0
<b>Total</b>	<b>274</b>	<b>100.0</b>

The results in table 4.9 show that only 8 respondents borrowed from SACCOs over the span of the three years (2013-2015). Majority of the respondents (98.2%) did not borrow a cent from the SACCOs. This could either signal that the enterprises are contented with the current capital base; or that they are unable to attract more capital

from these sources owing to the stringent requirements and this could also be as a result of the small number of SACCOs in the Country. The low percentage number of respondents taking loans could also be due to the fact that they do not undertake activities which guarantee need for external financing. Wang (2013) posited that, micro financing is mostly demand when SMEs are in unhealthy conditions, and that firms which used microfinance saw a significantly higher profit to SMEs than those that did not.

These findings are coherent to those obtained by Lemuel (2009) discovered that between 1-2% of small businesses in Nigeria borrowed from banks and other financial Institutions, and that of Njuguna (2015) who reported that only 8.05% of the respondents obtained financing from SACCOs while 4.6% got funds from commercial banks. Kibet et al. (2015) realized that only 36.2% of the enterprises in Uasin Gishu County opted to borrow other financial institutions as opposed to MFIs. The study went on to state that the low percentage of using loans only shows that business financial performance is sound thus SMEs are able to plough back profits to expand their business. Eriotis et al. (2007) also discovered that Greek firms use either very little or no long-term debt capital at all.

**Table 4.10: Average Borrowing from Friends**

<b>Amount</b>	<b>Frequency</b>	<b>Percentage</b>
Less than 20,000	253	92.3
20,001-40,000	17	6.2
40,001-60,000	3	1.1
60,001-80,000	1	.4
80,001-100,000	0	.0
Over 100,000	0	.0
<b>Total</b>	<b>274</b>	<b>100.0</b>

Table 4.10 shows that majority of the respondents (92.3%) borrowed at most Ksh. 20,000 while only a few of the respondents (7.7%) borrowed over Ksh. 20,000 from friends. This confirms the findings by Lemwel (2009) which observed that only a handful of SMEs were able to attract funding from friends.



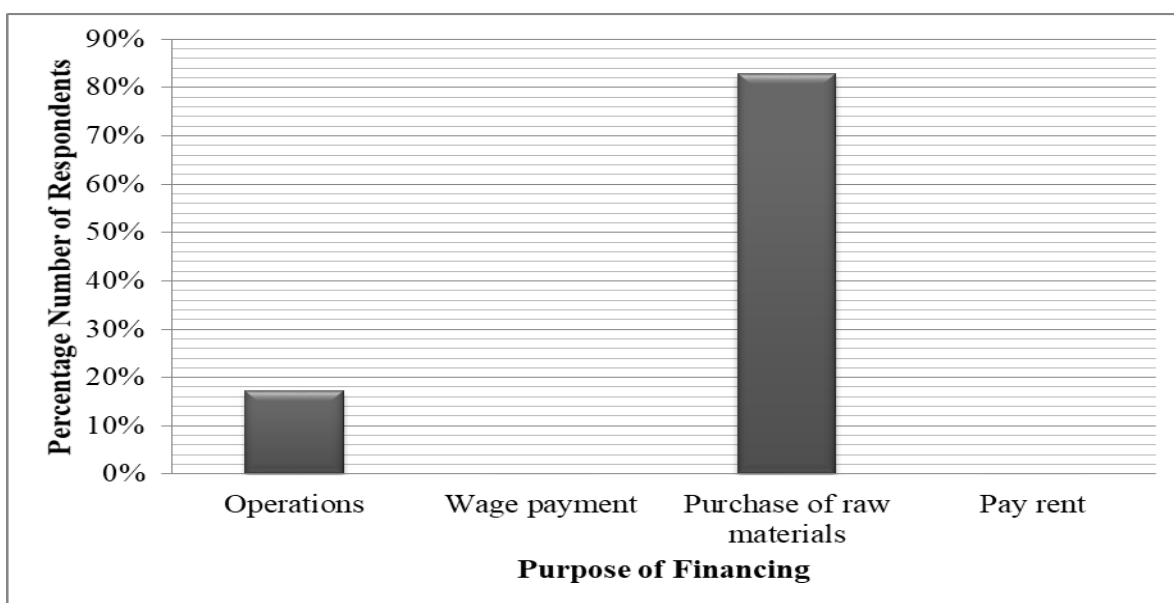
**Table 4.11: Average Borrowing from Family**

<b>Amount</b>	<b>Frequency</b>	<b>Percentage</b>
Less than 20,000	269	98.2
20,001-40,000	5	1.8
40,001-60,000	0	0.0
60,001-80,000	0	0.0
80,001-100,000	0	0.0
Over 100,000	0	0.0
<b>Total</b>	<b>274</b>	<b>100.0</b>

As table 4.11 depicts, majority of the respondents (98.2%) borrowed funds from their family members while only 1.8% of the respondents received funds from family members.

#### **4.17 Reasons for Seeking Debt Financing**

Respondents were asked to indicate the purpose for which debt financing was needed. The findings were as indicated in figure 4.6.



**Figure 4.6: Need for Debt Financing**

Figure 4.6 shows that 82.8% of the respondents sought debt financing in order to purchase raw material while only 17.2% of the respondents sought debt funds so as

to finance their operations. This finding contravenes that of Eriotis et al. (2007) who noted that Greek firms rarely use debt financing to offset the financial needs of their business.

#### **4.18 Enterprise’s Use of Retained Earnings as a source of Financing**

The study sought to know whether or not the proprietor(s) re-invested part of their gains in the business. The findings were as noted in table 4.12.

**Table 4.12: Re-Investment of Retained Earnings**

	<b>Frequency</b>	<b>Percentage</b>
Yes	15	5.5
No	259	94.5
<b>Total</b>	<b>274</b>	<b>100.0</b>

As displayed in table 4.12, it was evident that 94.5% of the respondents do not re-invest their gains while only 5.5% of the respondents re-invest part (or whole) of their gains back in the business. This contravenes the study by Kauffmann (2005) which stated that Africa’s SMEs usually depend on retained earnings as the main source of funds; and Bayrakdaroğlu et al. (2013) which found out that highly profitable firms prefer retained earnings as their funds, although it supported Obwori et al. (2012) who discovered that only a few SMEs spent the income to expand the businesses. The reason why majority of microenterprises do not re-invest their gains could be because most of the families rely on the gains for the family’s upkeep since most proprietors have no other sources of income. It could also be because most enterprises under study (carvers and finishers) require few equipment that could prompt re-investment of the gains. Most of them require a handful of tools to carry out their daily activities. However, it is worth noting that too much reliance on retained earnings as the main source of finance contributes to slow financial performance and use of crude equipment because of lack of capital (Nichter & Goldmark, 2009).

These findings are in harmony with Obwori et al. (2012) who realized that the income generated by soapstone entrepreneurs is mostly used for buying personal effects and food and that only a few of them use it to improve their skills and expansion of their businesses. However, the study contravenes the findings of Aterido, Driemeier and Pages (2011) whose results in a study on 70,000 enterprises in 107 countries observed that more than 67% of small businesses relied on retained earnings as a source of finance for investment.

#### 4.19 Amount of Retained Earnings Used as Financing in Enterprises

The study saw it necessary to determine the amount of profits that was re-invested into the business in the last 3 years. The findings are presented in table 4.13.

**Table 4.13: Amount Re-Invested**

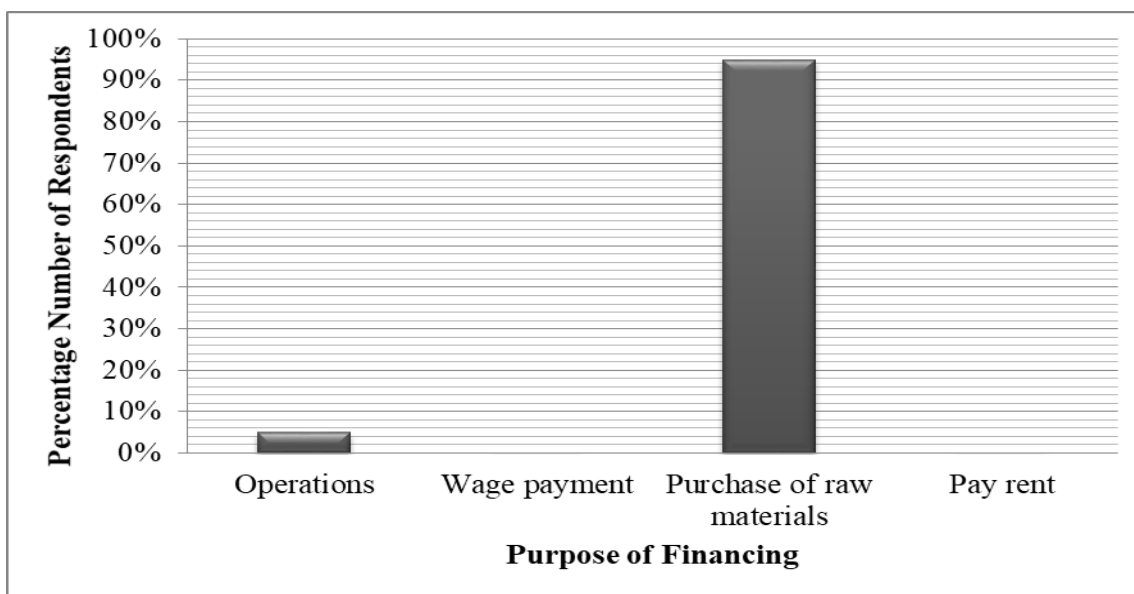
Amount	2013		2014		2015	
	Frequency	Percentage	Frequency	Percentage	Frequency	Percentage
Less than 20,000	267	97.4	266	97.1	265	96.7
20,001-40,000	1	0.4	3	1.1	3	1.1
40,001-60,000	4	1.5	2	0.7	3	1.1
60,001-80,000	1	0.4	0	0.0	0	0.0
80,001-100,000	1	0.4	3	1.1	3	1.1
Over 100,000	0	0	0	0	0	0
<b>Total</b>	<b>274</b>	<b>100</b>	<b>274</b>	<b>100</b>	<b>274</b>	<b>100</b>

The findings in table 4.13 disclose the fact that most 261 firms (95.3%) hardly re-invest to their capital in the three years under investigation, and that, for those that reinvest, the amount re-invested by the micro enterprises is generally low. This could

be due to the fact that most of the profits is usually used by the entrepreneurs to cater for their household needs since the businesses are their primary source of income, as observed by Obwori et al. (2012). It could also be that the craft industry is not so profitable. These results were in solidarity with Obwori et al. (2012) discovered that very little of the income generated from the soap stone business small scale enterprises in Tabaka is used to expand their businesses. However, the results are in disagreement with Kauffmann (2005) who opined that Africa’s SMEs usually depend on retained earnings, informal savings, among other savings, as the main source of funds; and that of Idowu (2010) which documented that 70% of Nigerian enterprises re-invest their earnings while South Africa’s enterprises re-invested 66% of their earnings. A recent study by Kibet et al. (2015) found out that 25.5% of retained earnings were re-invested.

#### 4.20 Reasons for Using Retained Earnings

Respondents were asked to indicate the purpose for which they used retained earnings to finance their business. The findings were as indicated in figure 4.7:



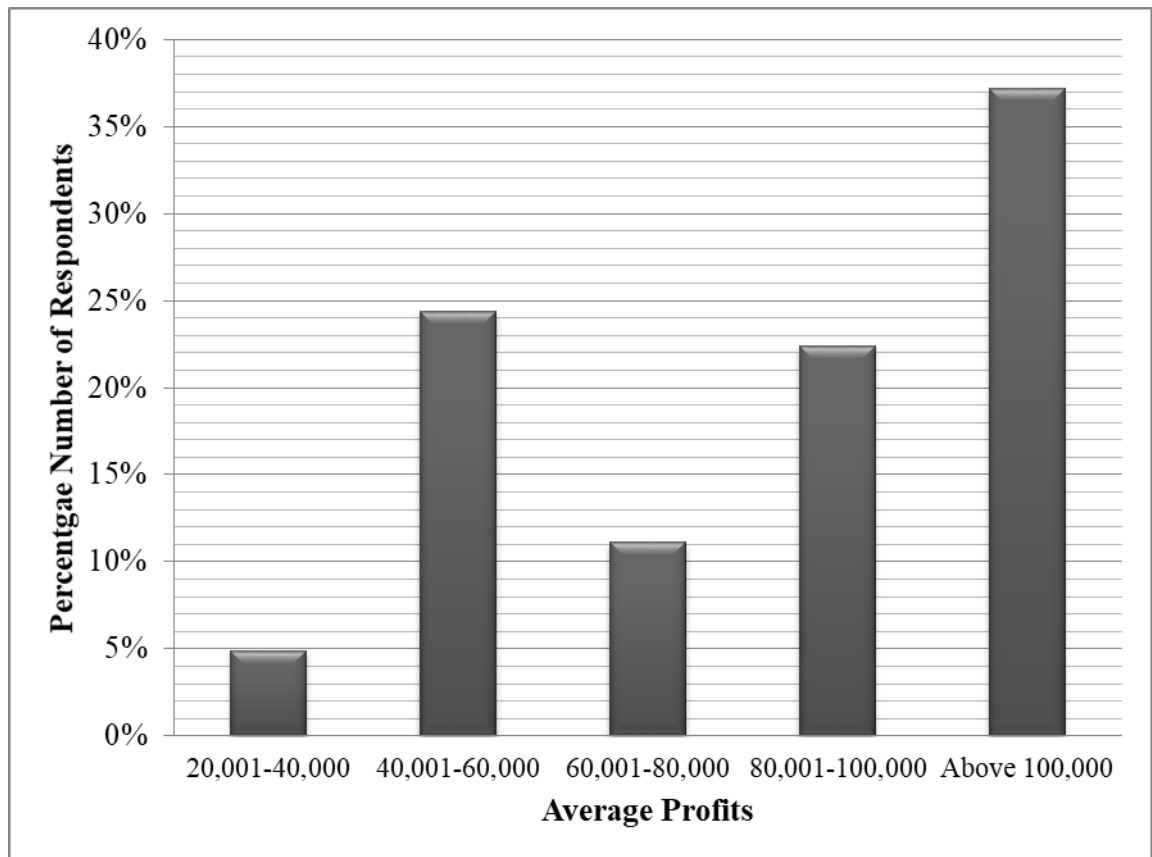
**Figure 4.7: Need for Use of Retained Earnings**

Figure 4.7 shows that 95% of the respondents used retained earnings in order to purchase raw material while 15% of the respondents used retained earnings to finance

business operations. Similar study by Idowu (2010) shared that Nigerian enterprises re-invest their earnings to increase their stock.

#### 4.21 Average Annual Profits of Craft Micro Enterprises

The study wanted to know the average amount of profits which the micro enterprises had realized in the previous three years. The results are indicated in figure 4.8.



**Figure 4.8: Average Annual Profits**

Figure 4.8 show that 37.2% of the respondents had realized an average annual profit of over Ksh. 100,000 while 24.4% of the respondents had realized an annual profit of between Ksh. 40,001-60,000. It was further observed that 22.4% of the respondents had realized an average profit ranging between Ksh. 80,001-100,000 while 11.1% of the respondents had realized an average profit of between Ksh. 60,001-80,000. The least percentage of the respondents (4.9%) earned between Ksh. 20,001-40,000. This shows that virtually all the enterprises are experiencing some profits, however small

it could be, this being an indication that they are also growing. This study mirrors Kibet et al. (2015) who stated that Small-scale loans can help relieve capital constraints that might otherwise preclude cash-strapped entrepreneurs from investing in profitable businesses, while savings services can create opportunities to accumulate wealth in safe repositories and to manage risk through asset diversification.

Wang (2013) warned that an increase in capital may not be necessarily associated with an increase in net profit or revenue but it is rather a way for SMEs to maintain their revenue and net profit growth in bad times. This means that even without increase in capital, the enterprise can increase profits, and this can be achieved for instance by increasing the sales turnover.

#### 4.22 Initial Sale Volume

The study wanted to know the initial sales volume that was realized at the end of the first year of business. The findings are tabulated in table 4.14.

**Table 4.14: Initial Sales of Craft Enterprises**

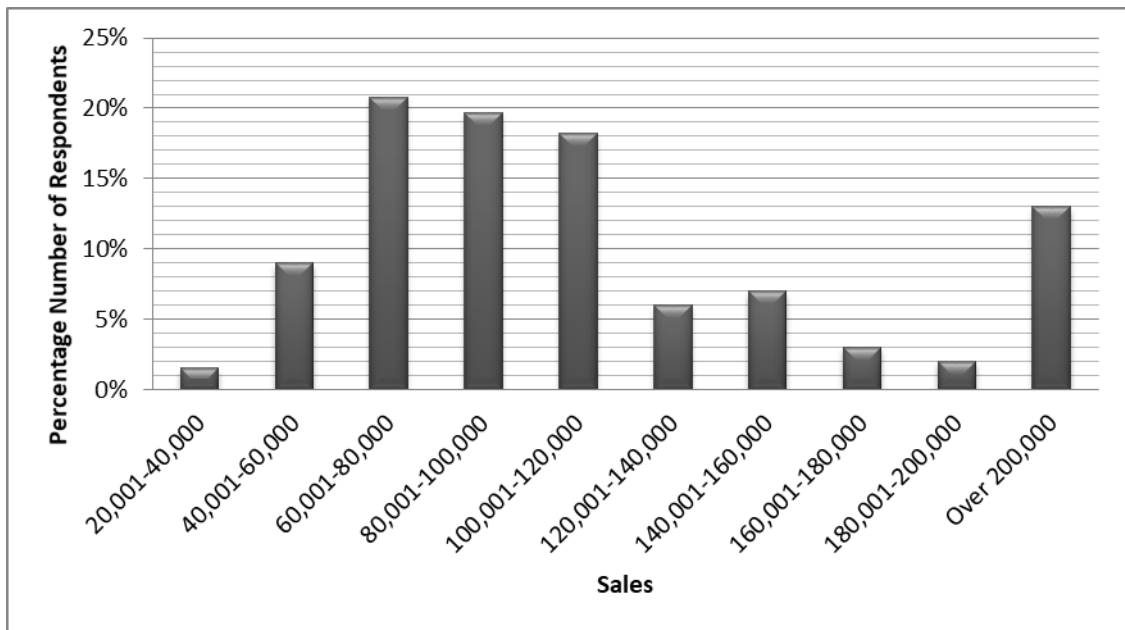
<b>Amount</b>	<b>Frequency</b>	<b>Percentage</b>
Less than 20,000	8	2.9
20,001-40,000	57	20.8
40,001-60,000	116	42.3
60,001-80,000	23	8.4
80,001-100,000	36	13.1
100,001-120,000	5	1.8
141,000-160,000	9	3.3
160,001-180,000	2	.7
180,001-200,000	12	4.4
Over 200,000	6	2.2
<b>Total</b>	<b>274</b>	<b>100.0</b>

The results in table 4.14 shows that the initial annual sales realized by the highest percentage of microenterprises ranged between Ksh. 40,001-60,000 and also between Ksh. 20,001-40,000 which were realized by 42.3% and 20.8% of the respondents respectively. These were followed by annual sales of between Ksh. 80,001-100,000 and Ksh. 60,001-80,000 that were attained by 13.1% and 8.4% of the microenterprises respectively. However, the findings of the study also indicated that the initial annual realized by the least number of craft micro enterprises ranged (at 0.7% and 1.8% of respondents) ranged between Ksh. 160,001-180,000 and Ksh. 100,001-120,000 respectively.

The reason why most enterprises experience low annual sales initially could be attributed to the entrepreneurs' failure to access loans. It could also be due to lack of local market, or due to the small stock of goods and the time it takes to sculpture an item, or that the businesses took some time before establishing customer base. Idowu (2010) realized that 62% of the respondents agreed that MFIs loans contribute high to their sales and marketing. A study by Ahmad et al. (2012) failed to establish any link between ROA and sales among the Malaysian firms. Eriotis et al. (2007) discovered that firms employ more debt capital experience greater sales in comparison with those firms that do not have debts.

#### **4.23 Average Sales for Previous Three Years**

The research wanted to determine the average sales that were realized by the enterprises in the previous three years. For this reason therefore, the respondents were asked to state their approximate sales in the previous three years and from these figures, the average was calculated. The findings yielded the following responses in figure 4.9.



**Figure 4.9: Summary of Average Annual Sales of Enterprises**

As figure 4.9 depicts the highest average annual sales attained by the enterprises ranged between Ksh.60,001-80,000 which was attained by 20.8% of the respondents. This was followed by Ksh. 80,001-100,000 which was realized by 19.7% of the respondents, and sales between Ksh. 100,001-120,000 was realized by 18.2% respondents. The least average annual sales were between Ksh.20,001-40,000 which was attained by 1.5% of the respondents. These findings lead to the conclusion that majority (58.7%) of the respondents had an average sales of between Ksh. 60,001-120,000. This translates to monthly sales between Ksh. 3,334-Ksh. 10,000. These sales are quite low and can be attributed to the low capitalization of the enterprises leading to low stock. Ruhu (2015) claimed that access to finance greatly influences the sales turnover of any enterprise.

Thereason why majority realized the low income could be due to the fact that most enterprises under study were relatively small service providing enterprises. Those that did retail business had relatively small stock of sculpture. Besides, most local people do not like buying these sculptures. A study by Kamunge et al. (2014) opined that 59.6% of the respondents' felt that sales is an effective measure of an enterprise's performance while 40.4% felt their method was very effective. Mateev



and Anastasov (2010) cited in Lucimbo (2016) claimed sales revenue, just like financial structure, productivity and total assets have a more direct impact on growth but caution that the number of employees, investment in research and development, and other intangible assets have minimal influence on the enterprise's growth prospects.

#### 4.24 Initial Startup Capital

Respondents were asked to disclose the initial capital for the business. The study revealed the following results in table 4.15.

**Table 4.15: Summary of Initial Capital of the Craft Microenterprises**

	Frequency	Percentage
Less than 20,000	103	37.6
20,001-40,000	46	16.8
40,001-60,000	35	12.8
60,001-80,000	12	4.4
80,001-100,000	32	11.7
100,001-120,000	18	6.6
120,001-140,000	3	1.1
141,000-160,000	6	2.2
180,001-200,000	11	4.0
Over 200,000	8	2.9
<b>Total</b>	<b>274</b>	<b>100.0</b>

The results displayed in table 4.15 shows that majority (37.6%) of the microenterprises were started with an initial capital of less than Ksh. 20,000 while 16.8% of the microenterprises were started with initial capital ranging between Ksh. 20,001-40,000. The study further indicated that 12.8% of the microenterprises were started with initial capital ranging between Ksh. 40,001-60,000 while only 11.7% of the craft microenterprises were started with initial capital ranging between Ksh. 80,001-100,000. The least population of microenterprises (1.1%) were established with an initial capital ranging between Ksh. 120,000-140,000 while the most

capitalized enterprises were those started with initial capital over Ksh. 200,000 and this constituted 2.9% of the microenterprises. This shows that majority (37.6%) of the respondents started their enterprises with an initial capital of less than Ksh. 20,000; with 83.3% of the respondents using an initial capital of less than Ksh. 100,000. The reason for this could be because of the nature of business activities they are undertaking. Most of the entrepreneurs only provided services which do not require much capital, for instance finishing or painting. It could also be because of lack of accessibility of extra capital. This finding conforms to that of Omondi (2013) who realized that 42% of small scale business entrepreneurs started their businesses with an initial capital of less than Ksh. 20,000. This finding also partly confirms Mwirigi's (2011) study which observed that, a majority of enterprises in Kenya had been started with capital lower than Ksh. 10,000 and that, only 16% of all enterprises had been started with capital exceeding KES 10,000.

Wang (2013) advised enterprises facing problems in terms of financial risks and low levels of productivity by opining that they can use micro financing as one of the most accessible approaches to finance themselves. According to the study, for SMEs with smaller revenue and smaller retained earnings, funding through micro financing is likely to be a big portion of their capital.

#### **4.25 Capital of Enterprises in Previous Three Years**

The study wanted to know the capitalization of the businesses in the previous three years. The aim of this question was to determine whether there was injection of more capital into the business by the entrepreneurs. The results are documented in table 4.16.

**Table 4.16: Capital of Enterprises in Previous Three Years**

Amount	2013		2014		2015	
	Frequency	Percent	Frequency	Percent	Frequency	Percent
Less than						
20,000	234	85.4	234	85.4	228	83.2
20,001-40,000	5	1.8	5	1.8	8	2.9
40,001-60,000	7	2.6	11	4.0	13	4.7
60,001-80,000	8	2.9	3	1.1	3	1.1
80,001-100,000	12	4.4	9	3.3	9	3.3
100,001-120,000	8	2.9	12	4.4	13	4.7
<b>Total</b>	<b>274</b>	<b>100</b>	<b>274</b>	<b>100</b>	<b>274</b>	<b>100</b>

The results shown in table 4.16 shows that majority (83.2%) of the microenterprises had been sailing on capital less than Ksh. 20,000 which they maintained over the three years under investigation. This could be because majority of the respondents were carvers, finishers and miners who do not need a lot of capital to purchase their work equipment. Other notable capitalization ranged between Ksh. 40,001-60,000 and Ksh. 100,001-120,000 each of which was used by 4.7% respondents in the year 2015. These are the categories of respondents who mainly owned retail shops.

From the above findings, it is evident that most of the craft microenterprises are still undercapitalized with 89.4% enjoying a capital base of Ksh. 100,000 or less. This finding differs with Mwirigi's (2011) study which observed that, 63% of the enterprises had net worth below Ksh. 200,000 while 15% of all enterprises recorded net worth of more than Ksh.600,000 per enterprise, and that accelerated business' financial performance was apparent in less than 20% of all enterprises interviewed.

Odero-Wanga et al. (2013) reported that, microenterprises with low capital investment, use of basic technology, rely on family labour and are located within proximity to home sites. This could be the reason why majority of these enterprises do not have any employee. Lucimbo (2016) lamented that most enterprises do not

survive to celebrate for more than three years because they tend to remain small which makes them more vulnerable to failure as a result of simple management mistakes as compared to large enterprises, and this means that there is no chance for MSE managers to learn from past mistakes since their capital base remains insufficient to absorb resultant losses.

#### 4.26 Return on Assets for the Enterprises

The study sought to know the Return On Assets (ROA) for the previous three years prior to the year in which the study was being carried. This was with a view to ascertain measure the profitability of the enterprises in relation to the assets. The result\ were as presented on table 4.17.

**Table 4.17: ROA for Enterprises**

<b>ROA</b>	<b>FREQUENCY</b>	<b>PERCENTAGE</b>
1-19.9	0	0.0
20.0-39.9	0	0.0
40.0-59.9	34	12.4
60.0-79.9	27	9.9
80.0-99.9	54	19.7
100.0 and above	159	58.0
<b>TOTAL</b>	<b>274</b>	<b>100</b>

As table 4.17 depicts, majority (58%) of the respondents had a ROA of over 100%. This could be due to the fact that their enterprises were service providers who had small value of assets compared to the profit they were making. It was also realized that 19.7% of the respondents had a ROA ranging between 80-99.9% while 9.9% of the respondents had a ROA ranging between 60-79.9%. It was also evident from the study that 12.4.9% of the respondents had a ROA of between 40-59.9%.

#### 4.27 Test on Normality

Tests for normality are vital especially when parametric tests such as correlation and regression analysis are used (Nyamute, 2016). For this reason therefore, this study found it absolutely necessary to carry out tests for normality. This was achieved by use of Shapiro-Wilk test on each of the independent factors versus the financial performance of craft microenterprises. Several other previous studies had found this test useful in testing for normality (Kimani, 2015; Chepkemoi, 2013; Ngugi, 2013). The Shapiro-Wilk tests reject the hypothesis of normality when the p-value is less than or equal to 0.05 (Ngugi, 2013). The Shapiro-Wilk test for internal equity financing yielded the following results in table 4.18.

**Table 4.18: Tests of Normality on Financial Performance of craft microenterprise/Internal equity**

<b>Shapiro-Wilk</b>			
	<b>Statistic</b>	<b>Df</b>	<b>Sig.</b>
Standardized	0.874	301	.183
Multiple Regression			

As table 4.18 shows, the results from Shapiro-Wilk test showed that the Standardized residuals are significantly normally distributed with a significance of 0.183 which is greater than 0.05; this being an indication that the variable, internal equity is normally distributed.

More analysis of Shapiro-Wilk test on debt financing (table 4.19) revealed that the Standardized residuals were significantly normally distributed with a significance of 0.683; which led to the conclusion that the data for debt financing was normally distributed.

**Table 4.19: Tests of Normality on Financial Performance of craft microenterprise/Debt Financing**

<b>Shapiro-Wilk</b>			
	<b>Statistic</b>	<b>Df</b>	<b>Sig.</b>
Standardized	0.661	301	.683
Multiple Regression			

The study tested the normality for retained earnings(table 4.20) and the findings from Shapiro-Wilk test revealed that the Standardized residuals were significantly normally distributed with a significance of 0.903; which was greater than 0.05. This implied that the variable, retained earnings is normally distributed.

**Table 4.20: Tests of Normality on Financial Performance of craft microenterprise/Retained earnings**

<b>Shapiro-Wilk</b>			
	<b>Statistic</b>	<b>Df</b>	<b>Sig.</b>
Standardized	0.661	301	.903
Multiple Regression			

#### **4.28 Statistical Checks for Multicollinearity**

Multicollinearity refers to a situation in which there is a high degree of association between independent variables of a study. To determine whether or not multicollinearity existed in the study variables, the researcher employed the use of Variance Inflation Factor (VIF) method. According to Hair et al. (2010), multicollinearity is said to exist between study variables when tolerance values are low and VIF values are higher. Wire (2015) asserted that, Variance-Inflation Factor is the reciprocal of tolerance, and that, a Variance Inflation Factor of more than 4.0 is

an indication of high multicollinearity. The analyzed data displayed tolerance and VIF shown on table 4.21.

**Table 4.21: Coefficients for Tolerance and VIF Tests**

<b>Independent variable</b>	<b>Collinearity Statistics</b>	
	<b>Tolerance</b>	<b>VIF</b>
Internal equity financing	.345	<b>2.902</b>
Debt financing	.662	<b>1.510</b>
Retained earnings	.569	<b>1.758</b>

The findings of this study realized that internal equity financing had VIF of 2.902, debt financing had VIF of 1.510 while retained earning had VIF value of 1.758. This shows that the VIF for all the variables under study were less than 4, leading to the conclusion that there was no multicollinearity among the study variables. Various previous studies also found these tests useful in determining their multicollinearity (Wire, 2015; Kimani, 2015; Abay, 2014; Ngugi, 2013).

#### **4.29 Test for Autocorrelation**

Chatterjee et al. (2013) defines Durbin–Watson statistic as a test statistic that is used to detect the presence of autocorrelation in the residuals from a regression analysis. This test statistic is useful in testing the null hypothesis that the errors are serially uncorrelated (Kimani, 2015). This test was deemed most appropriate to use in testing for autocorrelation because previous studies had used it and found it to be satisfactory (wire, 2015; Ruhu, 2015; Kimani, 2015; Osei-Assibey, 2010; Dagogo & Ollor, 2009). The value of Durbin-Watson statistic lies between 0 and 4 with 1.5-2.5 being the acceptable range. However, a value of 2 means that there is no autocorrelation in the sample (Verbeek, 2012). In order to determine whether or not there was autocorrelation, the study run a Durbin–Watson test and the value obtained (2.0162) was found to be close to 2 hence leading to the conclusion that there was no first order serial correlation (see table 4.22).

**Table 4.22: Model Summary**

<b>R</b>	<b>R Square</b>	<b>Adjusted R Square</b>	<b>Std. Error of the Estimate</b>	<b>Durbin-Watson</b>
.672 <sup>a</sup>	.452	0.096	9366.08274	2.0162

a. Predictors: (Constant), internal equity financing, debt financing, retained earnings

b. Dependent Variable: Financial performance of microenterprise

### 4.30 Statistical Checks for Heteroscedasticity

Heteroscedasticity means that previous error terms are influencing other error terms and this violates the statistical assumption that the error terms have a constant variance (Ngugi, 2014). To test for heteroscedasticity, a Park Test was run (table 4.23) and the all the test statistics were found to be less than 2. This means that there was no heteroscedasticity.

**Table 4.23: Park test for Heteroscedasticity**

<b>Variable</b>	<b>Coefficient</b>	<b>Std. Error</b>	<b>t-Statistic</b>	<b>Prob.</b>
Internal Equity Financing	0.993836	0.700783	1.41818	0.8885
Debt Financing	0.314261	0.082074	3.82900	0.6185
Retained Earnings	0.377521	0.262842	1.43630	0.8667

### 4.31 Correlations of the Study Variables

Correlation is normally used to test for multicollinearity by determine the relationship among a group of variables (Pallant, 2010). Multicollinearity refers to a situation in which there are two or more predictor variables in a multiple regression model are highly correlated (Rotich, 2016). The values obtained in the Pearson's correlation ranges between -1 and +1; with the closer the correlation values to -1 or +1 the greater the indication of multicollinearity. However, when correlation values



are not close to 1 or -1 it means that the factors are sufficiently different measures of separate variables (Farndale, Hope-Hailey & Kelliher, 2010), implying that the variables are not multicollinear. It's an indication that the variables are not autocorrelated (Kimani, 2015). Absence of multicollinearity allows the study to utilize all the independent variables (Ndung'u, 2014). The correlation among the independent variables involved in this study was as presented by the correlation matrix in table 4.24.

**Table 4.24: Correlations of the Study Variables**

<b>Variables</b>	<b>Financial Performance</b>
IE	.658**
DF	.425**
RE	.605**

\*\* Correlation is significant at the 0.01 level (2-tailed).

The findings in table 4.24 show that all the correlations were less than 0.7. The study noted that internal equity financing had a correlation of 0.658 with the financial performance, retained earnings had correlations of 0.605 with the financial performance of craft micro enterprises while debt financing had a correlation of 0.425 with the financial performance of craft micro enterprises. Tabachnick and Fidell (2013) asserted that a correlation of above 0.90 is a strong indication that the variables may be measuring the same thing. For this reason, all the factors of this study were considered to be measures of different variables. The fact that all the correlations were less than 0.90 was an indication that the factors were sufficiently different measures of separate variables, and consequently, all the variables this study were justified to be used.

## 4.32 Regression Results

### 4.32.1 Effect of Internal Equity Financing on Financial Performance of Craft

#### Microenterprises

The study wanted to determine the influence of internal equity financing on the financial performance of craft micro enterprises. To achieve this objective, the study carried out a linear regression analysis. Table 4.25 presents summary of regression model result obtained.

**Table 4.25: Model for Internal Equity Financing**

<b>R</b>	<b>R Square</b>	<b>Adjusted R Square</b>
.658 <sup>a</sup>	.433	0.092

The results displayed in table 4.25 shows that the value of R is 0.658. This implies that there is a strong positive linear relationship between internal equity financing and the financial performance of craft micro enterprises. The value of R square is 0.433 represents the explanatory power of the independent variable (internal equity financing) and this means that 43.3% of the variations in financial performance is explained by internal equity financing while the remaining 56.7% of the financial performance is determined by factors other than internal equity financing.

The outcome of the results of internal equity financing on financial performance of craft microenterprises yielded the ANOVA results in table 4.26. The p-value for ANOVA (0.000) is less than the critical value (0.05). This leads to the conclusion that, at 5% significance level, internal equity financing has influence on the financial performance of craft micro enterprises. These findings were in harmony with Mateev and Anastasov (2010) who concluded that internally generated funds were significant factor in determining a firm's growth and performance.

**Table 4.26: ANOVA<sup>a</sup> for Influence of Internal Equity Financing on Financial Performance of Craft Micro Enterprise**

			<b>Sum of</b>		<b>Mean</b>		
			<b>Squares</b>	<b>df</b>	<b>Square</b>	<b>F</b>	<b>Sig.</b>
Internal equity financing	Regression		421.85	5	84.37	7.02	.000 <sup>b</sup>
	Residuals		3232.98	269	12.02		
	<b>Total</b>		<b>3654.83</b>	<b>274</b>			

a. Dependent variable: financial performance of craft micro enterprise

b. Predictors: (Constant), Internal equity financing

The study determined the significance test result for internal equity financing. This was aimed at determining the coefficients for the linear regression equation of internal equity financing on financial performance of craft microenterprises and its significance. The regression equation was to be presented in the form;

$$Y = \beta_0 + \beta_1 IE + \varepsilon$$

Where;

$\beta_0$ -Coefficient of Intercept

$Y$ - Financial performance

$IE$ -Internal equity financing

$\varepsilon$ -Error term

Table 4.27 presents the table of coefficients for the effect of internal equity financing on financial performance. The results led to the formation of the linear regression model:

$$Y = 0.352 + 0.259IE \dots \dots \dots (1)$$

Model (1) shows that for every 1 unit increase in internal equity financing, financial performance of craft micro enterprise is predicted to have an increase by 0.259 units, but if no internal equity financing is used, the financial performance rate of the enterprises will be 0.352 units.

**Table 4.27: Significant Test Results for Internal Equity Financing**

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	.352	.179	.145	1.966	.000
IE	.259	.148	.389	1.750	.000

a. Dependent Variable: Financial Performance of Microenterprise

The study went further to determine the significance test result for the constructs of internal equity financing. The regression equation was to be presented in the form;

$$Y = \beta_0 + \beta_1 PR + \beta_2 PS + \beta_3 SA + \beta_4 SR + \varepsilon$$

Where;

*Y*-Financial Performance

$\beta_0$ -Coefficient of Intercept

*PR*-Profits

*PS*-Personal savings

*SA*-Sale of assets

*SR*-Savings from reduced capital

$\varepsilon$ -Error term

The results were as shown on table 4.28.

**Table 4.28: Significant Test Results for Constructs of Internal Equity Financing**

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	.018	.009		2.000	.029
PR	.059	.015	.101	3.933	.006
PS	.026	.014	.105	1.857	.000
SA	.011	.005	.013	2.200	.013
SR	.004	.021	.014	0.190	.000

a. Dependent Variable: Financial Performance of Microenterprise

From the results in table 4.28, the following regression model was obtained

$$Y = 0.018 + 0.059PR + 0.026PS + 0.011SA + 0.004SR \dots \dots \dots (2)$$

Model (2) shows that for every 1 unit injection of profit to the craft microenterprise, there occurs 0.059 units increase in financial performance of the enterprises; that for every unit increase in use of personal savings as an internal source of finance, there occurs 0.026 units increase in financial performance; that every unit increase in use of proceeds from sale of assets results in 0.011 units increase in financial performance and every use of one unit of savings from reduced capital as an internal source of finance results in 0.004 units in financial performance. However, if no internal equity financing is used, the financial performance rate of the enterprises will be 0.018 units. All the variables were significant since their p-values were less than the critical value of 0.05. These findings are in harmony with those of Wang (2013) who observed that personal funds had significant positive effect on the profit financial performance and revenue growth.

#### 4.32.2 Effect of Debt Financing on Financial Performance of Craft

##### Microenterprises

The study wanted to know the relationship between the second variable under study (debt financing) and financial performance of craft micro enterprises. For this reason, a regression of debt financing on the financial performance of craft micro enterprises was done and the findings produced the model summary shown on table 4.29. The table indicates that the value of R square for debt financing is 0.181. This means that, in isolation, debt financing alone accounts for 18.1% of all financial performance of craft microenterprises, with the remaining 81.9% of the financial performance of craft microenterprises being accounted for by other factors. The value of R (0.425) was a clear indication that there was a positive relationship between debt financing and financial performance of craft micro enterprises. Although the finding of this study contradicts that of Babajide (2012) who contended that access to microfinance does not enhance financial performance of micro and small enterprises; it supports that of Abor (2005) which contended that short term debts significantly and positively influenced the performance of a firm.

**Table 4.29: Model Summary for Debt Financing**

<b>R</b>	<b>R Square</b>	<b>Adjusted R Square</b>
.425 <sup>a</sup>	.181	0.086

In order to test the second null hypothesis which stated that ‘debt financing has no significant influence on the financial performance of craft micro enterprises’, an Analysis of Variance test was used. The findings from the ANOVA were as presented on table 4.30.

**Table 4.30: ANOVA<sup>a</sup> for Influence of Debt Financing on Financial Performance of Craft Micro Enterprise**

		<b>Sum of Squares</b>	<b>df</b>	<b>Mean Square</b>	<b>F</b>	<b>Sig.</b>
Debt financing	Regression	318.85	5	63.77	5.17	.026 <sup>b</sup>
	Residuals	3318.01	269	12.33		
	<b>Total</b>	<b>3636.86</b>	<b>274</b>			

Dependent variable: Financial Performance of craft micro enterprise

Predictors: (Constant), Debt financing

The p-value from table 4.30 was 0.026 and this was found to be less than the critical value (0.05) and this implied that, at 5% significance level, debt financing has significant influence on the financial performance of craft micro enterprises.

The study determined the significance test result for debt financing. This was aimed at determining the coefficients for the linear regression equation of debt financing on financial performance of craft microenterprises and its significance. The regression equation was to be presented in the form;

$$Y = \beta_0 + \beta_1 DF + \varepsilon$$

Where;

$Y$ - Financial Performance

$\beta_0$ - Coefficient of intercept

$DF$ -Debt financing

$\varepsilon$ -Error term

Table 4.31 presents the table of coefficients for the linear regression which led to model (3) below:

$$Y = 0.218 + 0.193DF \dots \dots \dots (3)$$

**Table 4.31: Significant Test Results for Debt Financing**

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	.218	.126	.141	1.730	.000
DF	.193	.072	.148	2.681	.000

a. Dependent Variable: Financial Performance of Microenterprise

Equation (3) shows that for every 1 unit increase in debt financing, financial performance of craft micro enterprise is predicted to have an increase by 0.193 units and that, if no debt financing is used, the enterprise will be having financial performance of 0.218 units.

The study determined the significance test result for the various constructs of debt financing so as to formulate a regression model of the form;

$$Y = \beta_0 + \beta_1CF + \beta_2SL + \beta_3FR + \beta_4FF + \varepsilon$$

Where;

$Y$ -Financial Performance

$\beta_0$ - Coefficient of intercept

$CF$ - Commercial Bank loans



SL-SACCO loan

FR-Funds from friends

FF-Family finance

ε-Error term

The results were as shown on table 4.32.

**Table 4.32: Significant Test Results for Constructs of Debt Financing**

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	.027	.029		0.931	.003
CF	.016	.005	.101	3.200	.000
SL	.011	.009	.105	1.222	.000
FR	.035	.015	.120	2.333	.006
FF	.028	.017	.156	1.647	.021

a. Dependent Variable: Financial Performance of Microenterprise

From the results in table 4.32, the following regression model was obtained

$$Y = 0.027 + 0.016CF + 0.011SL + 0.035FR + 0.028FF \dots\dots\dots(4)$$

Equation (4) shows that for every 1 unit increase in funding from Commercial Bank loans leads to 0.016 units increase in financial performance of the microenterprise; and that one unit increase in use of funds from SACCO loans lead to 0.011 units increase in financial performance of craft micro enterprise. It also shows that shows

that for every 1 unit of funds from friends injected to the microenterprise leads increase in financial performance of microenterprises by 0.035 units; while an increase of funds from family finance into the microenterprise by one unit results in financial performance of microenterprises under study by 0.028 units. However, if no debt financing is used, the financial performance rate of the enterprises will be 0.027 units. Since all the four variables had p-values less than 0.05, it led to the conclusion that they were all significant in the model.

### 4.32.3 Effect of Retained Earnings on Financial Performance of Craft

#### Microenterprises

The study sought to establish the link between the variable “retained earnings” and financial performance of craft micro enterprises. A regression of retained earnings on the financial performance of craft micro enterprises was carried out. The results displayed in table 4.33 shows that the value of R for retained earnings is 0.605. This means that there is a positive correlation between retained earnings and financial performance of craft microenterprises. The value of R square (0.366) implied that retained earnings contributed by 36.6% to the total financial performance of craft microenterprises while the remaining 63.4% of the variations in financial performance were brought about by other factors besides retained earnings. These findings were in harmony with Yazdanfar (2012) and Akingunola (2011) who realized that retained profit significantly influenced financial performance of enterprises.

**Table 4.33: Model Summary for Retained Earnings**

<b>R</b>	<b>R Square</b>	<b>Adjusted R Square</b>
.605 <sup>a</sup>	.366	0.0793

A regression of retained earnings on the financial performance of craft micro enterprises was done and the findings produced the ANOVA results shown on table 4.34.

**Table 4.34: ANOVA<sup>a</sup> for the Influence of Retained Earnings on Financial Performance of Craft Micro Enterprise**

		<b>Sum of Squares</b>	<b>Df</b>	<b>Mean Square</b>	<b>F</b>	<b>Sig.</b>
Retained earnings	Regression	318.45	5	63.69	7.74.	.002 <sup>b</sup>
	Residuals	2213.52	269	8.23		
	<b>Total</b>	<b>2531.97</b>	<b>274</b>			

- a. Dependent variable: Financial Performance of craft micro enterprise  
b. Predictors: (Constant), Retained earnings

The evidence on table 4.34 shows that the p-value from ANOVA was 0.002. This means that, at 95% confidence, retained earnings have significant influence on the financial performance of craft micro enterprises since the P-value for ANOVA (0.002) is less than the critical value (0.05). Similar results were observed by Akoto (2014) whose study showed that use of retained earnings led to financial performance of young enterprises. Upon analyzing the data to get significant test results for retained earnings, the following result in table 4.35 was obtained.

**Table 4.35: Significant Test Results for Retained Earnings**

Model	Unstandardized Coefficients		Standardized Coefficients		t	Sig.
	B	Std. Error	Beta			
(Constant)	.113	.115	.136		.982	.000
RE	.164	.036	.115		4.556	.000

- a. Dependent Variable: Financial Performance of Microenterprise

The findings in table 4.35 led to the formation of the regression model (5) below:

$$Y = 0.113 + 0.164 RE \dots\dots\dots(5)$$

Model (5) above shows that for every 1 unit increase in retained earnings, the financial performance of craft micro enterprise is predicted to have an increase by 0.164 units and that if no debt financing is used, the enterprise will experience a financial performance of 0.113 units.

#### 4.33 Overall Model Summary before Moderation

The multiple regression analysis was done with the aim of determining the linear relationship between the dependent variable (financial performance of craft micro enterprises) and independent variables (internal equity financing, debt financing and retained earnings), so as to formulate a model of the form;

$$\text{PERF} = \beta_0 + \beta_1\text{IE} + \beta_2\text{DF} + \beta_3\text{RE} + \beta_4\text{EE} + \varepsilon, \text{ where,}$$

**PERF**=Performance of Craft Micro Enterprise

**$\beta_0$** =Coefficient of Intercept

**IE**=Internal Equity Financing

**DF**=Debt Financing

**RE**=Retained Earning

**EE**=External Equity Financing

**$\beta_1, \beta_2, \beta_3$  and  $\beta_4$** =regression coefficient of four independent

variables

**$\varepsilon$** =Error term

The result of the model summary for the regression analysis was as presented on table 4.36.

**Table 4.36: Model Summary before Moderation**

<b>R</b>	<b>R Square</b>	<b>Adjusted R Square</b>	<b>Std. Error of the Estimate</b>
.770 <sup>a</sup>	.593	.589	.072

a. Predictors: (Constant), Internal equity financing, debt financing, retained earnings

As table 4.36 depicts, the value of  $R^2$  was found to be 0.593. This communicates the fact that 59.3% of the factors determining the financial performance of craft microenterprises are explained by the three independent variables under consideration in this study. The remaining 40.7% of the factors influencing the financial performance of micro enterprises are explained by factors outside the model.

#### **4.34 ANOVA<sup>a</sup> Results for the Overall Model Before Moderation**

The ANOVA result for the overall model was as shown on table 4.37. The model shows that the overall model is significant in explaining the variance in the financial performance of craft micro enterprises since its p-values (0.017) was found to be less than the critical value of 0.05.

**Table 4.37: ANOVA for the Overall Model before Moderation**

<b>Model</b>	<b>Sum of Squares</b>	<b>df</b>	<b>Mean Square</b>	<b>F</b>	<b>Sig.</b>
Regression	43754.25	5	8750.85	77.839	.017 <sup>b</sup>
Residuals	30240.98	269	112.42		
Total	73995.23	274			

a. Dependent Variable: Financial Performance of Microenterprise

b. Predictors: (Constant), Internal equity financing, debt financing, retained earnings

### 4.35 Regression Coefficients before Moderation

Table 4.38 shows the regression coefficients obtained before moderation. The coefficients were important since they were used to formulate the multiple regression equation representing the three independent variables before moderation.

**Table 4.38: Significant Test Results before Moderation**

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	.304	.091		3.341	.046
1 IE	.261	.048	.233	5.438	.000
DF	.146	.036	.199	4.056	.000
RE	.257	.131	.341	1.962	.000

a. Dependent Variable: Financial Performance of Microenterprise

From table 4.38, the positive values of beta imply that, all the independent variables under study have positive influence on the financial performance of craft micro enterprises as evident in their positive values of beta. The table also shows that, when all the factors under study (internal equity financing, debt financing and retained earnings) are held constant, the financial performance will be 0.304. It is also evident from the table that, every unit increase in internal equity financing will result in 0.261 units increase in financial performance of the craft microenterprise; that a unit increase in debt financing will result in a 0.146 units increase in financial performance of the craft microenterprise, and that a unit increase in retained earnings will result in a 0.257 units increase in financial performance of the craft microenterprise. Also, the p-values from the table showed that all the variables were significant. These findings on table were used to develop the optimal model and this yielded the multiple regressions model (8) for the financial performance of craft micro enterprises shown below:

$$\text{PERF} = 0.304 + 0.261 \text{ IE} + 0.246 \text{ DE} + 0.257 \text{ RE} \dots\dots\dots(8)$$

#### 4.36 Moderating Effect of Education Level on Financial Performance of Craft Microenterprises

For the purpose of testing the effect of the moderator, respondents' level of education was given in two categories (0=primary level and 1=post-primary level). The results of the model summary after taking into account the moderating effect of level of education on the relationship between the independent variables on the dependent variable was as presented on table 4.39.

**Table 4.39: Model Summary for Moderating Effect of Education Level**

Model	R	R Square	Adjusted R Square	F Change	Sig. F Change
1	.804 <sup>a</sup>	.647	.622	.0319	.054

a. Predictors: (Constant), Internal equity financing, debt financing, retained earnings, level of education

As table 4.39 displays, the value of R<sup>2</sup> for the model after moderation was .647 and this shows that 64.7% of the factors determining the financial performance of craft microenterprises are explained by the interaction between level of education and the independent variables. It is therefore evident from the finding that, by introducing the moderating effect of level of education to the study variables, the significance of the overall model increases from 0.593 to 0.647 (that is, from 59.3% to 64.7%) and this represents an increase of 5.4%. This shows a significant presence of the moderating effect of level of education on the relationship between the study variables and financial performance of craft micro enterprises. This result concurs with that of Kithae et al. (2013) who observed that education and training had a significant influence on the performance of a firm.

#### 4.37 ANOVA Results Moderating Effect of Education Level

The study sought to determine the ANOVA result for the overall model after moderation effect of the level of education and the results were as presented on table 4.40.

**Table 4.40: ANOVA for the Overall Model after Moderation**

<b>Model</b>		<b>Sum of Squares</b>	<b>df</b>	<b>Mean Square</b>	<b>F</b>	<b>Sig.</b>
1	Regression	916.7	5	183.34	8.033	.000 <sup>b</sup>
	Residuals	6139.48	269	22.82		
	<b>Total</b>	<b>7036.18</b>	<b>274</b>			

a. Dependent Variable: Financial Performance of Microenterprise

b. Predictors: (Constant), Internal equity financing, debt financing, retained earnings, level of education

The ANOVA results in table 4.40 shows that the independent variables ( $p=0.000$ ) in conjunction with the moderating variable were significant in explaining the variability of the dependent variable which was financial performance of craft micro enterprises.

#### 4.38 Regression Coefficients for the Moderating Effect of Education Level

Table 4.41 shows the regression coefficients obtained after moderation. The coefficients were important since they were used to formulate the multiple regression equation after moderation.



**Table 4.41: Significant Test Results after Moderation**

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	.367	.073		5.027	.029
IE	.277	.145	.206	1.910	.011
2 DF	.158	.099	.203	1.596	.026
RE	.272	.107	.313	2.542	.000
LE	.129	.039	.138	3.308	.010

a. Dependent Variable: Financial Performance of Microenterprise

The results shown in table 4.41 show that, when all the factors under study and the moderator are held constant, the financial performance will be 0.367. It also shows that, every unit increase in internal equity financing will result in 0.277 units increase in financial performance of the craft microenterprise; that a unit increase in debt financing will result in a 0.158 units increase in financial performance of the craft microenterprise; that a unit increase in retained earnings will result in a 0.272 units increase in financial performance of the craft microenterprise. It can further be seen that every unit inclusion of the moderating variable (level of education) results in 0.129 units increase in financial performance of the craft microenterprises. The values of beta for each of the variables are all positive, implying that, all the independent variables under study (internal equity financing, debt financing and retained earnings) have positive influence on the financial performance of craft micro enterprises. These findings on table 4.41 led to the formulation of linear regression model (9) for the financial performance of craft micro enterprises shown below:

$$\text{PERF} = 0.367 + 0.277 \text{ IE} + 0.258 \text{ DE} + 0.272 \text{ RE} + 0.129 \text{ LE} \dots \dots \dots (9)$$

From the above model (9), it is evident that the inclusion of the moderating variable (level of education) improved the effect of all the other independent variables (internal equity financing, debt financing and retained earnings) on the financial

performance of craft micro enterprises. Specifically, it was established that the inclusion of the moderating variable improved the influence of internal equity financing on the growth by 0.016 units (or 1.6%), it improved the influence of debt financing by 0.012 units (or 1.2%); while influence of retained earnings was improved by 0.015 units (or 1.5%) due to the interaction between external equity financing and the moderator.

This means that when an entrepreneur has a higher level of education, s/he will be able to make better use of the three sources of financing and this will led to a greater financial performance of the microenterprises relative to one who has lower level of education.

#### **4.39 Hypothesis Testing**

Ho<sub>1</sub>: The first null hypothesis stated that, “internal equity financing has no significant influence on financial performance of craft micro enterprises”. The p-value for internal equity financing was found to be 0.11 (table 4.41). Since this value is less than the critical value of 0.05, the null hypothesis is rejected and this leads to the conclusion that internal equity financing has a significant influence on financial performance of craft micro enterprises.

Ho<sub>2</sub>: The second null hypothesis stated that, “debt financing has no influence on financial performance of craft micro enterprises”. The p-value (0.26) for debt financing obtained in table 4.41 was less than the critical value of 0.05 and therefore the null hypothesis was rejected, leading to the conclusion that debt financing has a significant influence on the financial performance of craft micro enterprises.

Ho<sub>3</sub>: The third null hypothesis was “retained earnings have no significant influence on financial performance of craft micro enterprises”. As table 4.41 depicts, the p-value for the retained earnings (0.000) is less than the critical value (0.05), hence the null hypothesis is rejected. This implies that retained earnings have a significant influence on financial performance of craft micro enterprises.

Ho<sub>4</sub>: The fourth hypothesis of the study was “level of education has no significant moderating influence on the relationship between capital structure and financial performance of craft micro enterprises”. The p-value of level of education was 0.010 (table 4.41) which is less than the critical value of 0.05 hence the null hypothesis was rejected, leading to the conclusion that level of education has a significant moderating influence on the relationship between capital structure and financial performance of craft micro enterprises.

## **CHAPTER FIVE**

### **SUMMARY, CONCLUSIONS AND RECOMMENDATIONS**

#### **5.1 Introduction**

The chapter presents a summary of the findings of the study on the objectives by objective basis based on the findings from the analysis of the collected responses from the respondents. Based on the summary, the chapter also gives conclusions and then recommendations based on the findings deduced from the study.

#### **5.2 Summary of the Findings**

The main objectives of the study were to determine the influence of internal equity financing on financial performance of craft micro enterprises, to establish the influence of debt financing on financial performance of craft micro enterprises, to determine the influence of retained earnings on financial performance of craft micro enterprises, and to establish the moderating influence of level of education on the relationship between capital structure and financial performance of craft micro enterprises in Kenya. For these reasons therefore, the study analyzed the collected data and arrived at the following conclusions regarding the objectives.

##### **5.2.1 Influence of Internal Equity Financing on Financial Performance of Craft Micro Enterprises**

The first objective of the study was to establish the influence of internal equity financing on the financial performance of craft micro enterprises in Kenya. The findings of the study revealed that majority of the respondents have sourced their initial capital from internal sources of finance, especially from profits and their own their own savings. The study further realized that, during the course of running the enterprises, the entrepreneurs resulted in getting more capital (when need arises), mainly from the profits realized in the preceding year and also by sale of assets. These additional funds were required mainly to purchase raw materials. The calculated p-value of the ANOVA led to the conclusion that internal equity financing

has a statistically significant influence on the financial performance of craft microenterprises.

### **5.2.2 Influence of Debt Financing on Financial Performance of Craft Micro Enterprises**

The second objective of the study was to establish the influence of debt financing on the financial performance of craft micro enterprises in Kenya. The findings of the study realized that Commercial Finance Companies, SACCOs, funds from friends and relatives were the major source of debt financing for the micro enterprises. The calculated p-value of the ANOVA led to the conclusion that debt financing has a statistically significant influence on the financial performance of craft microenterprises.

### **5.2.3 Influence of Retained Earnings on Financial Performance of Craft Micro Enterprises**

The third objective of the study was to determine the influence of retained earnings on financial performance of craft micro enterprises in Kenya. The study echoed that, majority of the micro enterprises do not plough back their earnings to the business. The study witnessed a statistically significant influence of retained earnings on the financial performance of craft microenterprises as evident from the p-value of the ANOVA which is less than the critical value.

### **5.2.4 Moderating Influence of Level of Education on the Relationship between Financing and Financial Performance of Craft Micro Enterprises**

The fifth objective of the study was to establish the moderating influence of level of education on the relationship between capital structure and financial performance of craft micro enterprises in Kenya. When compared with the previous model without the moderating variable, it is evident that the variable “respondents’ highest level of education”, contributes more to the overall financial performance model. This means

that respondents' highest level of education contributes some significant percentage of the variations in the determinants of capital structure on financial performance of craft micro enterprises, and this is significant.

### **5.3 Conclusion**

The study aimed to determine the influence of capital structure on financial performance of craft micro enterprises in Kenya. From the above findings from this study, several conclusions can be drawn. First, most craft micro enterprises normally source their initial capital from internal sources of finance, especially from profits and from their own their own savings. This claim is in support of Brendea (2012) who documented that firms with more profitable projects are prone to use internal funds rather than debt. It is also evident from the study that, the craft micro enterprises prefer getting additional capital mainly from the profits realized in the preceding year and also by sale of assets so as to purchase raw materials for their enterprises. This finding complies with the earlier studies by Evbuomwanet al. (2012) who found out that majority of the MSMEs in Nigeria relied mostly on own funds to finance their businesses. Fourthly, it can also be observed that internal equity financing has a statistically significant influence on the financial performance of craft microenterprises.

Another important conclusion from the study is that, it is not easy for craft micro enterprises to secure debt financing when need arises. This claim is in disagreement with the findings of Huang Song (2002) who observed that most of China's listed companies are highly dependent on external financing. Sixthly, Commercial finance companies and SACCOs were noted to be the major sources of debt financing that had been made use of by the craft micro enterprises. This finding is in harmony with Wanambisi and Bwisa (2013) who lamented that, despite the efforts of microfinance institutions to take microfinance services within the reach of poor people and MSEs that have not benefited from the conventional formal financial system, growth and expansion of MSEs sector had not shown any sign of growth and expansion. This is majorly due to the proprietors' reluctance to seek bank loans (Olutunla & Obamuyi, 2008).

Another important conclusion that can be drawn from the study is that, majority of the micro enterprises do not plough back their earnings to the business, and this was found to contravene Bayrakdaroğlu et al.'s (2013) and Kauffmann's (2005) study whose findings demonstrated that that most SMEs usually depend on retained earnings as the main source of funds. On the other hand, Obwori et al. (2012) discovered that only a few SMEs spent the income to improve their skills, expansion of their businesses, or towards improving and growing the soapstone businesses. It is worth noting that, retained earnings too have significant influence on the financial performance of craft microenterprises, hence the reason why they should also use it as a source of financing.

#### **5.4 Recommendations**

Based on the above conclusions, the following recommendations were made: First, the proprietors of the craft micro enterprises should be encouraged to use internal sources of finance since it was realized that it has a significant influence on the financial performance of craft microenterprises. Secondly, the study perceived that craft entrepreneurs do not enjoy the services of debt financing because of the strings attached to it. For this reason, the financiers of loans should minimize the requirements for one to qualify for the products since this it was observed that debt financing also has influence on the financial performance of the enterprises.

Another conclusion that can be drawn from the study is that the financial institutions should lessen their restrictions on the requirements for one to qualify for a loan. This is because the micro enterprises hardly have collateral, while this is deemed to be one of the requirements for a business to qualify for a loan. The government should also sensitize the proprietors in this industry on book keeping, since it was observed that majority of the respondents under investigation did not have proper records regarding their businesses' financial progress. This is deemed important in the sense that some of the financial institutions demand financial records and/or bank statements so as to analyze before concluding on whether or not to award a loan. The government should sensitize and encourage the entrepreneurs on to use funds from friends and family members since these are cheap sources because they do not attract interests.

Besides, they do not dilute ownership structure of the enterprise. Lastly, the study observed that level of education contributes to the financial performance of enterprises, therefore the entrepreneurs should be encouraged to undergo some training especially in book keeping, for these will enable them to track their businesses' progress.

### **5.5 Areas for Further Research**

The model obtained from the study indicates that the independent variables under study only accounted for almost just a half of the variables determining the financial performance of craft micro enterprises. For this reason therefore, a study needs to be done to establish the other salient factors which determine the financial performance of craft micro enterprises. A study also needs to be done to establish the reasons for the enterprises' unwillingness to source finance from external sources. Lastly, a study needs to be done to determine the challenges faced by the craft micro enterprises in their business activities.



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## APPENDICES

### Appendix I: Questionnaire

#### INFLUENCE OF CAPITAL STRUCTURE ON FINANCIAL PERFORMANCE OF CRAFT MICRO ENTERPRISES IN KENYA

**Instructions:** Thanks for agreeing to participate in this research. You are kindly requested to give your response as honestly as possible. The information you give will NOT be used for any other purposes other than the research for which it is meant. Kindly place a tick where possible.

1. Please indicate your gender                      Male                       Female                     

2. Please indicate your age

Below 18 years                     

Between 18 and 35 years                     

Between 36 and 45 years                     

Between 46 and 55 years                     

Over 55 years                     

3. Please indicate the position you hold in this business

Owner/ manager                     

Spouse                     

Child                     

Employee                     

Other (specify).....

4. Please indicate your level of education

Primary [ ]

Secondary [ ]

Certificate [ ]

Diploma [ ]

Bachelors [ ]

Other [ ]

5. When was this enterprise established?.....

6. Who established the enterprise?.....

If you are not the one who established it, when did you take it over?

.....

.....

7. Please indicate the number of workers in the following categories

Category	Number of workers
Family Members	
Employees	

**Influence of Internal Equity Financing on Financial Performance of Craft Micro Enterprises**

8. Has your business borrowed money from internal sources of finance?

Yes [ ]

No [ ]

9. Please identify the amount of your initial and current financing of your firm from the following sources`

	<b>Initial financing (sh.)</b>	<b>Current financing (sh.)</b>
Personal savings		
Profits		
Sale of assets		
Savings from reduced capital		
Others (specify)		

10. Please identify the purpose for which the money was needed

- Operations
- Wage payment
- Purchase of raw materials
- Pay rent
- License

### **Influence of Debt Financing on Financial Performance of Craft Micro enterprises**

11. Has your business borrowed from financial institutions?

- Yes  No

12. Please state the amount of money your enterprise has obtained from the following sources in the last 3 years

<b>Source</b>	<b>Amount</b>		
	<b>2013</b>	<b>2014</b>	<b>2015</b>
Commercial bank loans			
Micro finance institutions loans			
SACCO loans			
Development bank loans			

Trade credit			
Credit unions			
Private placements			
Small Business Investment Companies			
Small Business Lending Companies			
Funds from friends			
Funds from family			
Business venture capital			
Business angels			
Overdrafts			
Any other (specify).....			

13. Please identify the purpose for which the money was needed? (Please tick where applicable)

Operations

Wage payment

Purchase of raw materials

Pay rent

License

Any other (specify).....

14. What effect do you think the debt had on the financial performance of your enterprise?

Retarded the business

No effect

Improved the business

**Influence of Retained Earnings on Financial Performance of Craft  
Micro enterprises**

15. Does your business re-invest part (or whole of) your gains from business so as to increase the capital of the business?

Yes                    [   ]                                  No                    [   ]

16. Please indicate the approximate amount of profits that was re-invested into the business in the last 3 years

<b>Source</b>	<b>Amount</b>		
	<b>2013</b>	<b>2014</b>	<b>2015</b>
Retained profits			
Dividends			
Error corrections			
Others (specify)			

17. Please identify the purpose for which the money was needed

- Operations                    [   ]
- Wage payment                    [   ]
- Purchase of raw materials    [   ]
- Pay rent                    [   ]
- License                    [   ]

18. Please indicate the total capital in your business: Ksh.

.....

19. What is the type of business ownership of your enterprise?

- Sole proprietorship                    [   ]
- Partnership                    [   ]
- Limited company                    [   ]
- Other (specify).....

20. If not sole proprietorship, who are the other owners and what are their amount of shares?

Shareholder	Amount (Ksh.)

**Financial Performance of Micro Enterprise**

21. Please indicate the approximate amount of profit that was realized by the business in the last 3 years

Year	Amount (Ksh.)
2013	
2014	
2015	

22. Please indicate the approximate sales volume you realized at the end of your first year of business: Ksh .....

23. Please indicate the approximate amount of sales that was realized by the business in the last 3 years

Year	Sales (Ksh.)
2013	
2014	
2015	

24. Please indicate the approximate proximate initial capital you started the enterprise with: Ksh.....

25. Please indicate the approximate capital which was in the business in the years indicated below:

<b>Year</b>	<b>Amount of capital (Ksh.)</b>
2013	
2014	
2015	

**THANK YOU**



**Appendix II: NACOSTI Identity Card**



Appendix III: NACOSTI Letter Page 1



**NATIONAL COMMISSION FOR SCIENCE,  
TECHNOLOGY AND INNOVATION**

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2241349, 3310571, 2219420  
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NAIROBI-KENYA

Ref. No.

Date:

**NACOSTI/P/16/43451/10510**

**25<sup>th</sup> April, 2016**

Steve Ondieki Nyanamba  
Jomo Kenyatta University of Agriculture  
And Technology  
P.O. Box 62000-00200  
**NAIROBI.**

**RE: RESEARCH AUTHORIZATION**

Following your application for authority to carry out research on ***“Influence of capital structure on growth of craft micro enterprises in Kenya,”*** I am pleased to inform you that you have been authorized to undertake research in **Kisii and Machakos Counties** for the period ending **19<sup>th</sup> April, 2017.**

You are advised to report to **the County Commissioners and the County Directors of Education, Kisii and Machakos Counties** before embarking on the research project.

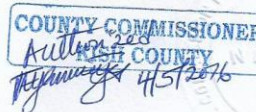
On completion of the research, you are expected to submit **two hard copies and one soft copy in pdf** of the research report/thesis to our office.

  
**BONIFACE WANYAMA**  
FOR: DIRECTOR-GENERAL/CEO

Copy to:

The County Commissioner  
Kisii County.

The County Director of Education  
Kisii County.



*National Commission for Science, Technology and Innovation is ISO 9001:2008 Certified*

**Appendix IV: NACOSTI Letter Page 2**

