EdinBurg Peer Reviewed Journals and Books Publishers
Journal of Finance and Accounting
Vol. 1: Issue 1: Pg. 1-8: ISSN: XXX-XXXX
Email: info@edinburgjournals.org

# Influence of Lending Procedures on Performance of Micro and Small Enterprises Business in Isiolo North Sub-County

**[1]Bornface Mwenda, [2]Susan Kambura & [3]Adel Kanyiri**

**[1]Department of Finance, Kenya Methodist University**

***Corresponding author's e-mail: bornface79@gmail.com**

***How to cite this article: Mwenda, B., Kambura, S., & Kanyiri, A. (2021).* Influence of lending procedures on performance of micro and small enterprises business in Isiolo North Sub-County. *Journal of Finance and Accounting, 1*(1), 1-8.**

## Abstract

Globally, MSE business is regarded as a critical economic development pillar. In Kenya, it is estimated that over 80% of employment opportunities are provided by the MSE sector (KNBS, 2019). According to sessional paper no. 10 of 2012, Isiolo County has been identified as a gateway for development of Northern parts of Kenya. Consequently, the county is emerging as a hub for entrepreneurial opportunities and has attracted businesses of all kinds (Muriithi, 2017). Nonetheless, businesses in Isiolo County still face serious challenges that impede their performance. The objective of the study was to establish the influence of lending procedures on performance of MSE's business in Isiolo North Sub-County. Descriptive sample test architecture was used in this report. This study considered the target population of 120 MSEs. The study found that lending procedures have a statistically significant and positive relationship with performance of MSE's business in Isiolo North Sub-County. The study concluded that lending procedures had a significant predictive ability to influence performance of MSE's business. The study recommends the need for financial institutions to improve the lending procedures in order to allow more MSE businesses access to credit. In particular, the financial institutions should make the loan application process simple, review loan repayment period and conduct proper client evaluation.

**Keywords**: *Lending procedures, performance, Micro and Small Enterprises*

### 1.0 Introduction

Lending Procedures relate to the mechanism observed in granting a borrower's credit. This might affect the SMS owners' chances of accessing credit and enhance their efficiency (Ssekiziyivu et al., 2017). On the other hand a micro business has 1-9 staff and a small business has 10-49 staff. MSEs are listed in Kenya using two major criteria: the number of people / employees and the average turnover of the company (Kivinda, 2018). For companies in the manufacturing sector, investment in plants and equipment as well as reported capital is taken into account in the description. The change to various degrees of the economies of many nations worldwide is attributed to MSEs (World Bank, 2015). MSEs, which make up 95 percent of all firms, are a dominant feature of the global business scene, according to the

Edinburg Community (2013). In addition, these entrepreneurial projects account for about 60 percent of private sector job opportunities.

According to the World Bank Report (2015) on the status of MSE in European countries, as they have realized the transformative position of MSEs, governments, development banks and central banks need to invest tremendously in this market. The European Commission (2016) considers micro and small-sized enterprises (MSEs) as the bedrock of Europe's economy, representing 99% of the continent's entrepreneurial transactions. Since 2011, around 85 per cent of all new jobs have been generated by MSE. In the production and growth of Micro and small Enterprises in Europe (MSE Europe), an organization that seeks to control EU policy in a way that benefits MSEs, the focus on MSEs as motors of the European economy is obvious (MSE Europe, 2016).

The economic development of Africa is also driven to a large degree by MSEs. 90 percent of all firms are MSEs in Sub-Saharan Africa (IFC, 2016). For instance, MSEs account for 91% and 92% of all enterprises in South Africa and Ghana, and contribute more than half of their national GDPs, respectively. 93% of all manufacturing companies in Morocco include those types of businesses (The Edinburg Group, 2013). Citing the case of Angola, Sousa dos Santos (2010) claims that MSEs in African countries are pivotal to economic development. In Nigeria, MSEs have a problem with credit accessibility (Eneh, 2017). The author argued that MSEs were not customer-friendly in lending procedures and that the credit system was poor in screening loan eligible borrowers, leaving potential borrowers unable to access credit.

### 1.1 Problem Statement

Globally, MSE business is regarded as a critical economic development pillar. In Kenya, it is estimated that over 80% of employment opportunities are provided by the MSE sector (KNBS, 2019). According to sessional paper no. 10 of 2012, Isiolo County has been identified as a gateway for development of Northern parts of Kenya. Consequently, the county is emerging as a hub for entrepreneurial opportunities and has attracted businesses of all kinds (Muriithi, 2017). Nonetheless, businesses in Isiolo County still face serious challenges that impede their performance.

Entrepreneurs have established restricted access to informal and formal credit as a major constraint to the growth of MSEs in Isiolo County (Karanja, Mwangi & Nyakarimi, 2016). The County is also characterized by high level of unemployment, particularly among the youths, nomadic life and low educational levels (Were, 2017), and all these can be attributed to limited access to credit. A report by USAID (2018) revealed that the poverty rate in Isiolo County was 72.6%. The high poverty level is indication that the MSE businesses in this County are not doing well. If they were performing well, then the poverty rate and unemployment levels ought to be declining. There is need therefore to determine the role of lending procedures in influencing success of MSE businesses in Isiolo County.

### 1.2 Objective of the Study

The objective of the study was to establish the influence of lending procedures on performance of MSE's business in Isiolo North Sub-County.

## 2.0 Literature Review

### 2.1 Theoretical Framework

The study was anchored on the Asymmetry Theory. Akerlof, Spence and Stiglitz (2001) developed the idea that knowledge asymmetry occurs in a lending market when a borrower who takes out a loan typically has greater information on the possible costs and returns associated with investment projects for which the funds are distributed. In the other hand, the lender does not have sufficient borrower-related information, as assumed information asymmetry poses two issues for financial institutions, moral hazard and adverse selection. MFIs find it difficult to solve these challenges because, as in the case of MFI loans, it is not feasible to dedicate energy to determining and recording where lending is for small sums.

This is because information is needed for the processing of applications and the tracking of borrowers is not readily accessible when and when it is necessary by financial institutions before lending to their customers. Therefore, when reviewing lending demands, MFIs face a condition of information asymmetry (Binks & Ennew, 2004). Derban, Binner and Mullineux (2011) have proposed that borrowers should be screened in the form of credit tests, in particular by banking institutions. In achieving efficient screening, as demonstrated by asymmetric information theory, the gathering of accurate information from prospective borrowers becomes crucial. In evaluating the borrowers, qualitative and quantitative approaches may be used, but their subjective aspect is one of the key difficulties in using qualitative models.

According to Derban et al. (2011), however, volumes using qualitative calculations for the sum of the properties relative to a threshold can be attributed to borrowers' characteristics. This strategy lowers material costs, lowers individual decisions and implicit biases. If it suggests improvements in the anticipated amount of credit loan defaults, the rating systems would be significant.

The theory is imperative in the current study since it explains the idea of information asymmetry in the debt market. In the case of information asymmetry, one party either the lender or the borrower lacks awareness about some crucial information that is likely to affect their credit decisions. This study focuses on lending procedures as a determinant of credit access by MSE. The theoretical prediction is that lending procedures determines credit accessibility, which may influence MSE success.

### 2.2 Empirical Review

Lending procedure refers to the formalities and methods used to supply a creditor with credit (Ssekiziyivu, Mwesigwa, Joseph & Nkote Nabeta, 2017). Any of the essential roles of financial institutions are the creation and execution of lending procedures (Widyaningsih, 2020). The financing system of a lender must be specific as to how much of the loan, the length and purpose of the loan, would be made available to whom. As such, lending procedures should be well designed to support lending officers in recognizing areas of prohibition and areas of distribution.

For the evaluation of the loan application, Ong'era and Onditi (2016) noted that loan procedures are required. A proper credit risk setting, a sound loan issue mechanism, adequate loan administration, estimation, tracking and follow-up of credit risk, policies and strategies must be developed that specifically describe the nature and distribution of lender loan facilities and the approach to credit portfolio management. Using loan terms, collection activities, loan time and collateral requirements, Kungu et al. (2015) assessed lending procedures.

Calomiris, Larrain, Liberti and Sturgess (2017) analyzed the implicit contracts between lenders and borrowers in Los Angeles. The study employed a cross sectional survey method. The findings revealed that banking lending relationships can motivate high effort and timely repayments. The study is relevant in this research since it explains the concept of lending procedures. Nonetheless, there exists a conceptual gap since the research did not focus on performance as the dependent variable.

A study by Ab Manan and Shafiai (2015) on risk management of Islamic Microfinance product by financial institutions in Malaysia established that short term loans will impact on MSEs will be acknowledged during fascination of new financing; advance period will potentially be shorter as the MFIs may be worried about the possibility that that they are eminent to pay their very own advance since they are more uncertain that they will recover their remarkable credits. They asserted that some MFIs compel potential borrowers to deposit some cash prior to being awarded some credit facility and the debtors are required to save the money with the lenders during the period of the credit facility. The expenses of cash borrowers get on these stores are well beneath the rates borrowers pay on their advances. However, the analysis presents a contextual gap given that it was carried out in Malaysia.

Ong'era and Onditi (2016) analyzed the effect on financial returns of commercial banks in Kenya of lending procedures and adopted a descriptive research style. Regression analysis was used to assess the relationship between the two variables. The findings showed a favorable association between the financial performance of commercial banks and the policies for loan financing. In addition, regulatory strategies, competitiveness and technologies in the banking sector also have important impact on banks returns. The study is relevant since it focused on lending procedures. However, the context of the study was commercial banks and not MSE.

The effect of credit policy on the viability of manufacturing companies in Kenya was analyzed by Kungu, Wanjau, Waititu and Gekara (2015). Credit terminology, payment activities, credit time and quality performance were the main variables. A descriptive research design was employed. Stratified random sampling method was applied. Findings indicated a direct connection between profitability and credit policy. The study nonetheless reveals a contextual gap since it focused on firms in Nairobi County and not Isiolo. Furthermore, the study was confined to firms in manufacturing sector only.

Anyieni (2016) examined the terms of commercial bank loans that affect small businesses in Kisii County. The study found that competition, pricing, and stringent bank requirements were important factors in the affordability of MSE commercial bank loans. The study concluded that the majority of the population was blocked from the official financial sector because of the many strict requirements and conditions that banks must have to open accounts or access loans because their information was not captured. Nonetheless, the research focused on MSEs in Kisii and not Isiolo County.

## 3.0 Research Methodology

Descriptive sample test architecture was used in this report. The study was based in Isiolo town which is the headquarters of Isiolo North Sub-County in Isiolo County. There are 120 MSEs within Isiolo town licensed by the Isiolo County government (Isiolo County

EdinBurg Peer Reviewed Journals and Books Publishers
Journal of Finance and Accounting
Vol. 1: Issue 1: Pg. 1-8: ISSN: XXX-XXXX
Email: info@edinburgjournals.org

Government, 2019). These MSEs have been in operation for at least 3 years and fall under trade and service categories. The target respondents were MSE owners or managers. This study considered the target population of 120 MSEs to be relatively small and therefore manageable to survey all of them. Primary data was gathered using structured questionnaires. The drop and pick later technique was applied. Descriptive analysis was used to analyze data.

## 4.0 Results and Discussion

### 4.1 Descriptive Statistics

The study's fit goal was to examine the effect of lending procedures on the performance of MSEs in Isiolo North Sub-County. The participants were asked to state whether they agree or disagree with assertions on lending procedures.

**Table 1: Descriptive Statistics on Lending Procedures**

| Statements | 1 | 2 | 3 | 4 | 5 | M |
|---|---|---|---|---|---|---|
| The loan application process is not easy and this increases the time it takes to access credit. | 0(0%) | 9(9.3%) | 3(3.1%) | 41(42.3%) | 44(45.4%) | 4.2 |
| The repayment period of the loan is favorable and therefore encourages business entrepreneurs to apply for credit. | 3(3.1%) | 27(27.8%) | 2(2.1%) | 37(38.1%) | 28(28.9%) | 3.6 |
| There are few regulation's when accessing credit for business | 48(49.5%) | 38(39.2%) | 5(5.2%) | 6(6.2%) | 0(0%) | 1.7 |
| There is less of client evaluation hence it's very easy to access credit | 47(48.5%) | 43(44.3%) | 0(0%) | 6(6.2%) | 1(1%) | 1.4 |
| It's a requirement to state the purpose of the loan before accessing it. | 6(6.2%) | 27(27.8%) | 2(2.1%) | 29(29.9%) | 33(34%) | 3.3 |

The outcomes in Table 1 reveal that most of the participants agreed with the following three assertions on lending procedure: the loan application process is not easy and this increases the time it takes to access credit (87.7%, m=4.2), the repayment period of the loan is favorable and therefore encourages business entrepreneurs to apply for credit (67%, m=3.6), and it's a requirement to state the purpose of the loan before accessing it (63.9%, m=3.3). On the other hand, the participants disagreed with the claim that there are few regulations when accessing credit for business (88.7%, m=1.7), and there is less of client evaluation hence it's very easy to access credit (92.8%, m=1.4). This implies that as much as the repayment period of the loan is favorable but the loan application process is difficult. The responses from the respondents also imply that there are many regulations when accessing credit. The fact that loan application process is difficult and there are many regulations is likely to deter access to credit by MSEs. The findings support Gichuki et al. (2017) argument that lending procedures such as short repayment period hinder credit access by small businesses.

The participants were requested to rate their satisfaction with lending procedures and the performance of their business.

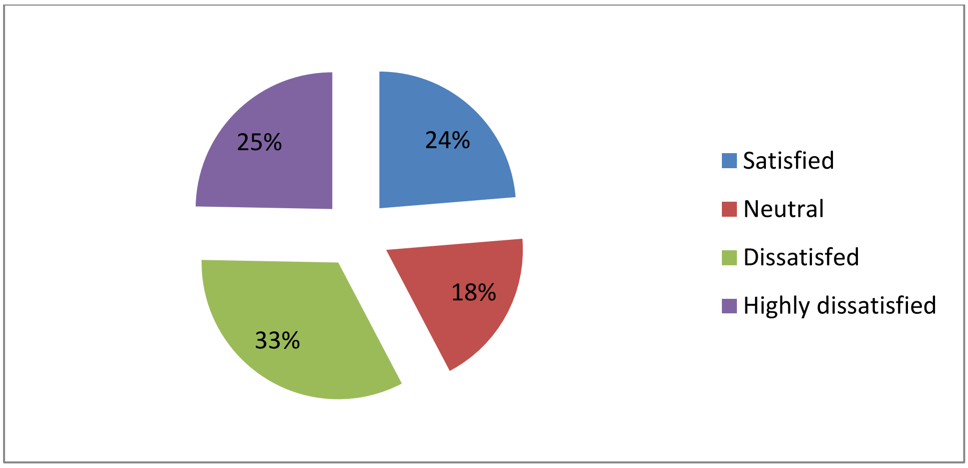


**Figure 1: Satisfaction with Lending Procedures**

The outcome in Figure 1 reveals that 33% of the participants were dissatisfied with the lending procedures, 25% were highly dissatisfied while 24% were satisfied. The findings confirm the respondents' views in Table 1 that the loan application process is not easy and this increases the time it takes to access credit.

**4.2 Hypothesis Testing using Correlation Analysis Results**

This section provides findings on the correlation between the independent variables (lending procedures and dependent variable (performance of MSEs).

**Table 2: Correlation Matrix; Lending Procedures and MSEs Performance**

| | | **Performance of police officers** |
|---|---|---|
| Performance of MSE | Pearson Correlation | 1 |
| | Sig. (2-tailed) | 0.000 |
| Lending Procedures | Pearson Correlation | 0.775** |
| | Sig. (2-tailed) | 0.000 |

The outcome in Table 2 reveal that lending procedures, (r =.775, p = .000), had a strong direct and noteworthy association with the performance of MSEs. The first null hypothesis ($H_{01}$) predicted that there was no noteworthy connection between lending procedures and performance of MSEs. The computed *P*-value was 0.000 at 95% confidence level implying that lending procedures had a direct and noteworthy connection (r= .755) with performance of MSEs. The null hypothesis was therefore rejected and settled that there was a noteworthy connection between lending procedures and performance of MSE. The findings imply that lending procedures significantly contribute towards performance of MSEs. The findings were similar to those of Ong'era and Onditi (2016), who argued that corporate efficiency and loan repayment policies have a good relationship.

## 5.0 Conclusion

The study concluded that lending procedures have a statistically significant and positive relationship with performance of MSE’s business in Isiolo North Sub-County. Furthermore, when combined with other variables, lending procedures had a significant predictive ability to influence performance of MSE’s business. Key aspects of lending procedures were identified, that is, repayment period, loan application process and client evaluation. These aspects are paramount in determining credit accessibility.

## 6.0 Recommendations

Lending procedures had a statistically significant and positive relationship with output of MSE’s business in Isiolo North Sub-County. The study recommends the need for financial institutions to improve the lending procedures in order to allow more MSE businesses access to credit. In particular, the financial institutions should make the loan application process simple, review loan repayment period and conduct proper client evaluation

## References

Ab Manan, S. K., & Shafiai, M. H. B. M. (2015). Risk management of Islamic microfinance (IMF) product by financial institutions in Malaysia. *Procedia Economics and Finance*, *31*, 83-90.https://doi.org/10.1016/S2212-5671(15)01134-X

Akerlof, G., Spence, M., & Stiglitz, J. (2001). Markets with Asymmetric information. *Committee, Nobel Prize*. Retrieved from https://www.nobelprize.org

Anyieni, A. G. (2016). MSE's access to credit, a case of kisii county-kenya. *International Journal of Engineering, Science and Mathematics*, *3*(1), 1. https://www.academia.edu/download/55676785/2945_pdf.pdf

Calomiris, C. W., Larrain, M., Liberti, J., & Sturgess, J. (2017). How collateral laws shape lending and sectoral activity. *Journal of Financial Economics*, *123*(1), 163-188. https://www.sciencedirect.com/science/article/pii/S0304405X16301568

Derban, A., Binner, R., & Muslineux, K. (2011). *Globalization, enterprise and knowledge: education, training and development in Africa*. Kluwer Academic Publishers. Retrieved from https://doi.org/10.1525/cmr.2015.57.4.63

Eneh, S. N. (2017). *Accessibility of credit facility from financial institutions by micro and small scale enterprises: Evidence from Nigeria* (Doctoral dissertation). https://www.oer.unn.edu.ng/read

Gichuki, J., Njeru, A. & Tirimba, O. (2017). The challenges facing MSE Enterprises. *Australian Journal of Business and Management Research 2* (2), 31-38. https://www.researchgate.net/publication/293026433

Karanja, J., Mwangi, A., & Nyakarimi, S. (2016). Analysis of factors influencing access to credit services by women entrepreneurs in Kenya. *Research Journal of Finance and Accounting*, *5*(11). Retrieved from https://ssrn.com/abstract=2493114

Kivinda, J. N. (2018). *Effect of growth of micro and small enterprises on economic development in Kajiado County, Kenya* (Doctoral dissertation, KCA University). Retrieved from http://41.89.49.13:8080/xmlui/handle/123456789/1402

Muriithi, S. (2017). African micro and small enterprises (MSEs) contributions, challenges and solutions. https://www.researchgate.net/profile

Ong'era, J. O., & Onditi, L. A. (2016). Influence of Loan Lending Policies on Financial Performance of Commercial Banks in Kenya. *International Journal of Economics, Commerce and Management*, *4*(11), 239-253. Retrieved from http://ijecm.co.uk/wp-content/uploads/2016/11/41123.pdf

Ssekiziyivu, B., Mwesigwa, R., Joseph, M., & Nkote Nabeta, I. (2017). Credit allocation, risk management and loan portfolio performance of MFIs—A case of Ugandan firms. *Cogent Business &Management*, *4*(1), 1374921.\

Widyaningsih, A. (2020). Financial Distress In Indonesia: Viewed From Governance Structure. *Jurnal Riset Akuntansi dan Keuangan*, *8*(2), 205-220. https://10.17509/jrak.v8i2.27796