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Effect of Collateral Requirement by Micro Credit Institutions on Performance of Small-scale Youth Enterprises in Rarieda Sub County, Kenya

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Abstract:

Credit availability is very key for the growth of any business enterprise within Kenya. These credits improve business performance in terms of increase market access, profitability and product innovativeness. Small scale youth enterprises play important role in job creation and poverty creation in Kenya but they have not been able to access credit due to security required and this affects their performance. There has been need to determine the relationship between collateral requirement by microcredit institutions and performance of small-scale youth enterprises. The purpose of this study was therefore to determine the effect of collateral requirement by microcredit institutions on performance of small-scale youth enterprises owned by youths in Rarieda Sub county, Kenya. The study used a sample of 53 respondents from a target population of 204 youth entrepreneurs using descriptive research design. From research study it was concluded that these businesses which had accessed loan using collateral registered improved performance as opposed to those who did not accessed loan due to lack of collateral. Hence the study concluded that lack of collateral negatively affects performance of small-scale youth enterprises. The research is hopes that the findings of this study will contribute to the existing literature on collateral requirement and performance of enterprises

Keywords: Collateral requirement, youth enterprise, Kenya

1. Introduction

This chapter discusses background information of the study, statement of the problem, objective of the study research question, significance of the study, scope of the study and limitation of the study

1.1. Background Information

In the global world, small scale enterprises play a major role in job creation, new product development and innovation as well as delivering goods and services to the people at the grassroots level (Bank, 2017). In the recent years across the globe SSE's are important engine for economic growth due to deliberate government policies and legislations aimed at nurturing SSE's as agent of economic growth and employment creation. It is estimated that small scale enterprises contribute to over 90 percent of total enterprises in most economies with high rate of employment growth. In USA and European Union countries it is estimated that SSE's contributes to over 60 percent in employment creation and over 40 percent to gross domestic product (G.D.P). In Asian's countries such as Malaysia, India, china, Japan and South Korea also have flourishing SSE sector contributing to over 70 percent in employment creation and estimated 40 percent contribution to their respective G.D.P's

In Africa, economic powerhouses such as Nigeria, Egypt, South Africa and Kenya, SSE's sector is estimated to contributes over 70 percent in employment creation and over 30 percent contribution to G.D.P

In Kenya, small scale enterprises are a priority for a country's employment creation and poverty reduction (Atieno, 2001). The government of Kenya (G.O.K) highly recognizes the contribution of SSE to economic development. The sector creates employment opportunities for the young generation that are jobless and cannot find in the formal sector. Currently the government gives much attention to the sector because it is the solution to the increasing unemployment level among the youth and has come up with various policies to facilitate the establishment and survival of this sector. Some of these policies include the economic recovery strategy for wealth and employment creation 2003-2007 which identified SME's sector as one of the sectors to facilitate economic recovery and growth. Another policy paper was policy paper No 2 on the development of micro and small enterprises for wealth creation and employment was published (G.O.K 2005). The document outlined policies for developing SME's including the need to increase access to financial services.

1.2. Statement of the Problem

Even though small-scale enterprises play crucial role in the economic development of different countries such as contribution to G.D.P, employment creation as well as poverty reduction, despite their significance small scale enterprise sector are faced with threat of failure as past statistics indicate that over 60% of small businesses are estimated to fail each year (Kenya bureau of statistics, 2007). For Small scale enterprises to grow, they need financial services to enhance their

productivity, profitability and growth. Sievers (2004) holds the view that access to financial and business development services are essential for growth and development of micro and small-scale enterprises. Small scale enterprises operates with limited capital which has not been enough for them to meet the cost of operations, due to this many SSE may resort to borrow from MFI's to acquire more funds to enhance the growth of their business, these credits from MFI's are quite available in Kenya and they include SMEP dtm, K-rep, Faulu Kenya and so on but still few small scale youths entrepreneurs seems to be accessing this credit, worse still those accessing this credit seems not to be performing any better and there growth has remain low and their sizes remain small (Bloom and Van Reenen, 2010). Therefore, this makes it important to investigate effect of collateral requirement by microcredit institution on performance in Rarieda sub county, Kenya.

1.3. Objective of the Study

The specific objective of the study was to determine effect of collateral requirement by micro credit institutions on performance of small-scale enterprises owned by youths in Rarieda Sub County

2. Literature Review

2.1. Collateral Requirement and Growth of SSE Owned by Youths

Collateral is an asset pledged by a borrower to a lender until a loan is paid back. If the borrower defaults then the lender have the right to seize the collateral and sell it to pay off the loan an in-bankruptcy proceedings, a secured lender has first claim to the proceeds from the collateral. Historically, collateral has often played an important role in the decision making.

The use of collateral dates back least to ancient Athens in the fourth century B.C. lender have always been interested in finding ways to ensure repayment of their loans, and collateral weather property, a farmer's cow or a family's mortgage house has often served this purpose. In modern banking, the use of collateral is widespread and common practices in both developed and developing countries for example in developed countries such as United States of America about 70 percent of all loans are made of secured loans since they are required to have support of a collateral (Berger, A. and Udell, G. , 1988) Heyes (1977) indicates that many lending institutions require all their loans to be supported by collateral. Although practices differ among lending institutions, traditional banker's views collateral as a means that can be used to offset some weaknesses. Alternative lending philosophy however weights collateral more heavily and as a result, allows more flexibility in accepting weather financial statements in making a lending decision.

Although MFI's is a great tool for poverty reduction, it only offers limited support for youth entrepreneurs who wish to expand their enterprises who need credit beyond micro level. Thus, youths' entrepreneurs who need credit beyond micro loan limits from micro finance institutions have difficulties in obtaining a credit higher than a micro credit. Youths are forced to participate in leading groups and very few are individually able to access financing since they do not have resources to act as collateral

A study conducted by Pius (2010) on the influence of micro credit finance on the growth of small-scale women entrepreneurs in Mosochi division, Kisii central district. A simple random sampling was used to sample 36 responded. The research finding revealed that the small-scale enterprises face problems in operating businesses and lack of collateral to access loan come up as a major challenge in the study. The study established that the entrepreneurs did not receive as much loan as they needed as the process involved in accessing loans was lengthy and the study revealed further that repayment period affects cash flow into the business

Another study conducted by Mira, and Ogolla, (2013) on the challenges facing accessibility of credit facilities among women owned enterprises in Nairobi central business district and using stratified sampling technique to sample 144 enterprises established that lack of collateral such as lack of lock books and lack of land title deeds limits women entrepreneurs in accessing finance. The study established that legal regulations and customary rules often restrict women from access to and control over assets failing to secure maximum loan. The study further established that financial institutions perceived women as risky borrowers due to lack of adequate collateral.

2.2. Conceptual Framework

This study conceptualizes the relationship between collateral requirement (Independent variable) and performance of small-scale youth enterprises (dependent variable) as shown in the figure 1 below

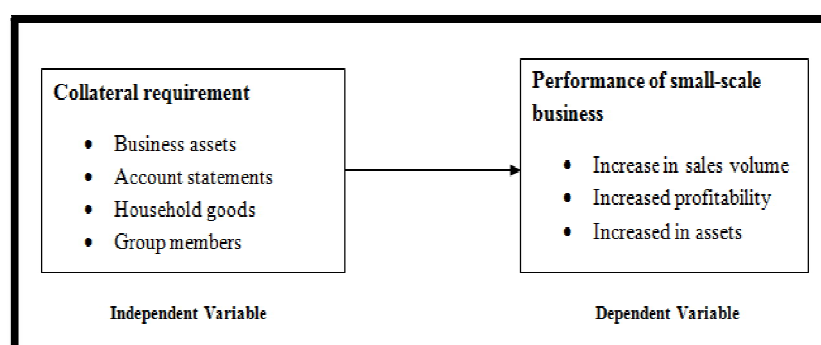


Figure 1: Conceptual Framework

3. Methodology

The study employed the descriptive survey design to help in showing how collateral requirement by microcredit institutions affects performance of small-scale youth enterprises. This design was appropriate for this study because it assisted the researcher to produce statistical information on effects of collateral requirement on performance of small-scale youth enterprises

The target population for this study comprises small scale youth enterprises who were beneficiaries of micro credit in Rarieda sub county, Kenya. The research used simple random sampling where a sample of 53 youth enterprises was drawn from the population

A self-administered questionnaire was used to gather information. The tools were pilot tested on a sample of five youth's enterprises in Bondo Sub County. The study used content validity index method to establish the validity of the entire designed questionnaire. In order to enhance reliability, the questionnaire was tested using Cronbach's coefficient alpha. The Cronbach alpha coefficient for the items in the questionnaire was above 0.7 indicating that the information gathered with the research instrument was regarded as satisfactory.

Data analysis was done using descriptive statistics and result from quantitative data were presented by use of frequency distribution inform of percentages and tables while responses from qualitative data was grouped into themes and reported. The data analysis was aided by use of statistical package for social sciences (SPSS) for easy interpretation. Cross tabulation was used to show relationship between independent variable and dependent variable

4. Findings and Discussion

4.1. Response Rate

The study administered one set of questionnaires to a sample of 53 respondents identified for the study as shown in the Table 1

Response rate	Frequency	Percentage
Returned	50	94.0
Unreturned	3	3.0
Total	53	100.0

Table 1: Questionnaire Response Rate

A total of 50 questionnaires were returned by the respondents representing 50(94%) response rate and 3(6%) did not return their questionnaire.

4.2. Background Information of the Respondent

The study sought all demographic characteristics of survey respondents by gender, age range, education level, experience in business and the type of business they are involved in. The aim of analyzing the demographic characteristics was to see how these characteristics influence response to MCI services. The response was presented in tables weighted to the population sample

4.2.1. Gender of the Respondents

The data collected from the sample based on gender was to determine how gender played part in small scale enterprises owned by youths in Rarieda Sub County. The Table 1 shows the response on gender.

Gender	Frequency	Percentage
Male	30	60.0
Female	20	40.0
Total	50	100.0

Table 2: Distribution of Respondents by Gender

From Table 2, majority of those running small scale businesses were male constituting 30(60%) while women accounted for 20(40%). This is an indication that both genders were involved in this study and thus the finding of the study did not suffer from gender bias.

4.2.2. Age Distribution of the Respondent

The study sought to establish the age distribution and therefore requested the respondents to indicate their age category as it would assist the researcher to identify the majority age set of the entrepreneurs. The Table 3 illustrates the responses on age

Age	Frequency	Percentage
18-24	12	24.0
25-30	20	40.0
31-35	18	36.0
Total	50	100.0

Table 3: Distribution of Respondents by Age

From Table 3 out of 50 entrepreneurs who participated in the study, 12 (24%) of the respondents were aged between 18- 24 years, 20 (40%) indicated they were aged between 25- 30 years and 18 (36%) of the respondent indicated that they were aged between 31- 35 years. This is an indication that the respondents were well distributed in terms of their age.

4.2.3. Marital Status of the Respondents

Marital status of youths is of great importance to youth concentration in business. This is because the nature of the family of any person determines to great extend their effort in doing business. In view of this, the respondents were required to give their marital status. Table 4 illustrates the captured results as per their responses

Marital status	Frequency	Percentage
Single	21	42.0
Married	29	58.0
Total	50	100.0

Table 4: Distribution of Respondents by Marital Status

As shown by Table 4, 21(42%) of the respondents were single and 58% of the respondents were married. This implies that the majority of the respondents are those youths who are married. This construed to the fact that youths have family responsibility and are opting to start business to support their families.

4.2.4. Education Level of the Respondents

This was of concern to the study as it would reveal the education background of the respondents. In view of this, the respondents were asked to give their education level as illustrated in Table 5.

Level of Education	Frequency	Percentage
Primary	25	50.0
Secondary	16	32.0
College	9	18.0
Total	50	100.0

Table 5: Distribution of the Respondents by the Level of Education

From the findings, 25(50%) of the respondent indicates their level of education as primary level, 16(32%) of the respondents indicate their highest level of education to be secondary level and 9(9%) of the respondents indicated their highest level of education as post-secondary education. This is an indication that most of the respondents focused in this study had primary education as their highest level of education.

4.2.5. Years' Experience in the Business

The years' experience in business by the respondents was very valuable to the study. Due to this the respondents were asked to indicate their experience in business as this would help to explain the degree of experience in business as shown by table 4.6

No of years in business	Frequency	Percentage
Below 1 year	6	12.0
1-3 Years	24	48.0
4-6 Years	12	24.0
7-10 Years	5	10.0
Above 10 years	3	6.0
Total	50	100.0

Table 6: Distribution of Respondents by Business Experience

From the finding of the study as shown in the Table 5, the study established that 12% of the respondents had been in the business below one year, 24(48%) of the respondents indicated that indicated that they had been in the business for a period between 1- 3 years, 12(24%) had been in the business between 4- 6 years, 5(10%) of the respondents had been in the business between 7- 10 years and 3(6%) of the respondent indicated that they had been in

the business for more than 10 years. This implies that majority of the respondents had been in the business for quite considerable time.

4.2.6. Nature of Business Enterprise of Respondents

The study sought to find out from the respondents the nature of business enterprises they are involved in. as shown in figure 4.7

T/ of business	Frequency	Percentage
Trading sector	29	58.0
Service sector	14	28.0
Agribusiness	7	14.0
Total	50	100.0

Table 7: Respondents Type of Business

From the research findings, 29(58%) of the respondents are in the trading sector, 14(28%) of the respondents indicated that they are in service sector while 7(14%) of the respondents indicated that they are in agricultural sector. This shows that majority of the small-scale entrepreneurs in Rarieda Sub County are in the trading sector

4.3. Descriptive Analysis of Study Variables

The demand of collateral by microcredit institutions before they give out credit to borrowers has effect on the growth of small-scale enterprises owned by youths. The second objective of the study sought to examine how collateral requirement influence growth of small-scale enterprises in Rarieda Sub County. The respondents were therefore asked to indicate weather collateral affects the growth of their enterprises.

4.3.1 Collateral Requirement and Credit Access

In the view of this objective, the respondents were asked to respond if microcredit requires collateral for borrowing or not as shown in the Table 11.

Collateral Requirement	Frequency	Percentage
Yes	48	96.0
No	2	4.0
Total	50	100.0

Table 8: Response on Collateral Requirement

From research findings, 48(96%) of the respondents indicated that microcredit institutions require collateral for loans while only 2(4%) of the respondents indicated that microcredit institution does not require microcredit collateral for loans. This implies that microcredit institutions do require security before giving loans to their clients.

4.3.2. Collateral Used In Borrowing

Those who borrow from microcredit institutions normally pledge assets they have as a security to enable them obtain credit from finance institutions. In view of this, youth entrepreneurs were asked to indicate collateral used in securing loans from microcredit institutions as shown in the table 4.12.

Collateral	Frequency	Percentage
the business asset	24	48.0
Bank statement	2	4.0
group member	6	12.0
household goods	18	36.0
Total	50	100.0

Table 9: Response on Collateral Used In Borrow

From the research finding, 24(48%) of the respondents indicated business assets as security for borrowing, 2(4%) of the respondents indicated bank statement, 6(12%) of the respondents indicated group members and 18(36%) of the respondents indicated household goods as security for borrowing from microcredit institutions. This shows that majority of the respondents used household goods and business assets as security to obtain loan from microcredit institutions.

4.3.3. Collateral Availability and Performance of SSE

The researcher sought to access the influence of collateral requirement by micro credit institutions and performance of small-scale youth enterprises in Rarieda Sub County, Kenya.

Access to credit	Frequency	Percentage
Yes	45	90.0
No	5	10.0
Total	50	100.0

Table 10: Response on Availability of Collateral and Access to Credit

From the research findings, out of 50 respondents, 45(90%) indicated that availability of collateral required by microcredit institution enhances access to credit by the youth enterprises and only 5(10%) indicated that availability of collateral is a hindrance to access to credit

Performance	Frequency	Percentage
Increased sales volume	28	56.0
Increased profit	14	28.0
Increased no. of employees	5	10.0
No effect on performance	3	6.0
Total	50	100.0

Table 11: Response on Performance of Business after Obtaining Loan Using Collateral

From the study findings, the researcher indicated that small scale youth enterprises sales volume was the main measure of performance by 28(56%), followed by increased profit 14(28%) and increase in number of employees at 5(10%). Those who indicated that access to credit and obtaining loan has no effect on business performance were 3(6%). This implied that availability of collateral to access credit from microcredit institutions by youth enterprises in Rarieda Sub County has positive effect on performance since majority of the respondents at 94% indicated that they witnessed improved performances on their businesses after obtaining loan using pledged collateral.

5. Conclusion

Lack of collateral by youth enterprises limit access to credit by small scale youth enterprises, from research findings, 96% indicated that microcredit institutions require collateral before giving loans to youths and this prevent them from obtaining loan hence negatively affect their growth. Those enterprises who are able to obtain credit indicated that such credit obtained against collateral had positive effects on the performance of their enterprises

6. Recommendation

Small scale youth enterprises face a lot of challenges which need to be addressed since these challenges affects their performance. From research findings it was evidenced that collateral requirement is a challenge to credit access hence microcredit institutions should adjust their terms and conditions of credit access which will intern increase credit access by small scale youth entrepreneurs

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