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Influence of Equity Financing on the Growth of Micro, Small and Medium Enterprises. A Critical Literature Review

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Abstract

Purpose: Greatest potentials in driving economies of the developing countries such as Kenya are within the Micro, Small and Medium Enterprises sector which account for almost over 90% of the businesses in these countries. The overall objective of this study was to examine influence of equity financing on the growth of micro, small and medium enterprises. A critical literature review

Methodology: The paper used a desk study review methodology where relevant empirical literature was reviewed to identify main themes and to extract knowledge gaps.

Findings: The researcher concludes that MSMEs financed by the venture capitalist that were under study experienced growth in both financial and non- financial aspects as well as in the managerial practices. This study reaffirms the correlation between MSMEs growth in any economy and poverty or lifestyle degradation. The economic impact of venture capitalist has been realized by MSMEs in sales, profit and asset upsurge.

Unique Contribution to Theory, Policy and Practice: The study recommends that government owned venture capital firms need to be privatized to serve entrepreneurs better. The youth and women development funds which should be venture capital funds but are not as interest is paid by borrowers and no monitoring of businesses should be privatized to become a true venture capital fund to serve young entrepreneurs better. MSMEs using equity financed capital should be given tax concession to attract other SMEs financed by financial institutions. This will open an avenue for their growth after which they will be big industries. This study has shown that the influences of equity financing have been seen and felt and so more businesses should be encouraged to use this type of finance for economic development.

Keywords: *Examine, Influence, Equity Financing, Growth, Micro, Small Medium Enterprises*.

INTRODUCTION

The microfinance revolution came about more than two decades ago with an aim of catapulting development in various arenas of the economy (Samer, 2015). However, the spread off the adoption of the microfinance model did not happen until mid-1990s. During this time, microfinance programmes and institutions came up and aimed to foster that growth of many micro-enterprises, especially in developing countries. The term micro-finance was defined by the United Nations in the year 2005 as basic financial services such as savings, credit and insurance. This concept enabled people to borrow, invest, and protect their families against various forms of risk. As observed, microfinance institutions are not only useful for levying credit but also aim at levying the accumulation of assets for poor people (Dahir, 2015).

Harper (2003) explains that the aspect of microfinance originated from Bangladesh at around 1976 as a result of the pioneer research conducted by Dr. Muhammad Yunis who was a professor of Economics. Globally, Small to Medium Size Enterprises (SMEs) are being hailed for their pivotal role in promoting grassroots economic growth and equitable sustainable development (Bazk,2022). In the United States of America (USA) and European Union (EU) countries Small Medium Enterprises are enterprises with employees under 500 while in developing countries any enterprise employing below 100 employees would constitute a Small Medium Enterprise. Small Medium Enterprises have become more important in the economic matrixes in recent years across the globe through increased deliberate government policies and legislation aimed at nurturing Small Medium Enterprises as engines of economic growth and employment creation. It is estimated that Small Medium Enterprises constitute over 90 percent of total enterprises in most economies with a high rate of employment growth. They are also a vehicle for increased industrial production and exports. In the USA and EU countries it is estimated that Small Medium Enterprises contribute over 60 percent in employment, 40-60 percent to Gross Domestic Product (GDP) and 30-60 percent to exports (Aziz,2017).

The Asian countries such as India, Indonesia, China, Malaysia, Japan, and South Korea also have thriving Small Medium Enterprises sectors contributing between 70-90 percent in employment and an estimated 40 percent contribution to their respective Gross Domestic Products (Schaper,2020). In Africa, economic powerhouses such as South Africa, Egypt, Nigeria and Kenya, the Small Medium Enterprises sector is estimated to contribute over 70 percent in employment and 30-40 percent contribution to Gross Domestic Product, but contribute less than four percent to export earnings (Makena,2014). The small and medium enterprises (SMEs) play an important role in the Kenyan Economy. According to the Economic Survey (2006), the sector contributed over 50 percent of new jobs created in the year 2005. Despite their significance, past statistics indicate that three out of five businesses fail within the first few months of operation (Kenya National Bureau of Statistics, 2007).

Among the inexhaustible list of factors that could enhance development of Small and Medium Enterprises is adequate finances and good financial management among the Small and Medium

Enterprises. Finance and financial related services are an important prerequisite in initiation, development and growth of business enterprises. Every business whether large, medium or small requires some level of financing in order to sustain its operations and expand. Financial institutions provide finance solutions to facilitate the aforementioned business requirements. With large business enterprises, it is not a difficult task to obtain financing from financial institutions and hence can easily walk into banking facilities and get loans to finance their business operations, Cotei (2017). A survey done by the Motta (2020) confirms that generally, large firms have access to bank credit and other financial services both local and foreign than small firms. The situation is however, different for Small and Medium Enterprises who heavily rely on internal funds and retained earnings. The issue of formal microfinance lending has existed in Kenya since 1950s as a result of a Joint Loan Board Scheme established by the colonialists (Mwololo, 2015).

Just after Kenya gained independence, the government of Kenya embarked on a program which aimed to ensure that people from rural settings were provided with credit services. This factor influenced other financial institutions to venture into the practice drawing profits and helping to enrich the rural communities as a result. The inception of microfinance institutions was convenient in the growth of small and medium enterprises since large banks usually transact with large and middle companies due to reduced risks associated with them. Small and Medium Enterprises are also associated with poor creditworthiness which most commercial banks tend to shy away from. These institutions are, therefore, a major form of funding for small and medium enterprises in the entire of Africa and other developing countries (Musamali,2013).

As of the year 1999, Kenya had 1.3 million small and medium enterprises employing about 2.3 million people in Kenya. This accounts for about 20% percent of all employed people. According to the National micro and small enterprise baseline for 2013, there is a great relationship between microfinance institutions and Small and Medium Enterprises in Kilifi County (Kilifi Blog, 2015) .Growth of Micro, Small and Medium Sized Enterprises (MSMEs) throughout the world has been of great interest to development economists, entrepreneurs, governments, venture capitalist, financial institutions and nongovernmental organizations among other stakeholders (Baker, 2006). MSMEs are seed-beds for the development of large companies and are the life blood of commerce and industry at large in any economic sphere both developed and developing (Wakaba, 2014). Globally, MSMEs are hailed for their pivotal role in promoting grassroots economic growth and equitable sustainable development in various societies' (Kiraka,2015). The MSMEs sector in Kenya, accounts for about 80% of the country's employable population and it's in dire need for government and private sector assistance to secure more funding (Memba, 2013). Researchers have been keen to determine the contributions of MSMEs to economic development and growth in particular, to job creation (Maengwe,2016).

The necessity to grow MSMEs and increase their contributions has increased over the last two decades, especially in developing nations, where MSMEs are believed to contribute significantly to unemployment and poverty alleviation and ownership of productive sectors. MSMEs growth ability depends highly on their potential to invest in restructuring, innovation and technology. All these investments need capital and therefore access to finance is the major MSMEs development and growth factor (Anyanga,2016). MSMEs fail to obtain capital financing mostly due to their failure in providing sufficient business information; financial guarantees as well as they are insufficiently informed or poorly advised about the appropriate financial sources. MSMEs will and do play a significant role in contributing to the national goal of wealth creation and making Kenya an industrialized country as it aims to achieve its millennium development goals as outlined in the vision 2030 blueprint. The limiting milestones to MSMEs in Kenya from acquisition of capital financing include lack of tangible and intangible security coupled with inappropriate legal and regulatory framework that does not recognize innovative strategies for lending to MSMEs by the various financial institutions (Berisha,2015). Limited access to formal finance due to poor and insufficient capacity to deliver financial services to MSMEs continues to be a constraint in the growth and expansion of the sector. Formal financial institutions perceive MSMEs as high risk and commercially unviable, as a result only a few MSMEs access credit from formal financial institutions in the country (Legg, 2015). Venture Capital is one source of non-bank financing, which is quite prevalent in developed and developing countries in particular Kenyan financial markets for small or startup firms (Samantha, 2018). It is against this background that the study intended to examine influence of equity financing on the growth of micro, small and medium enterprises.

Statement of the Problem

Many parts of Kenya are built by small and medium enterprises. However, they have a high mortality rate due to lack of sufficient financing from financial institutions. Over 60% of small and medium enterprises collapse within a year of being established (KNBS, 2007). Small and Medium Enterprises continue to fail from the problems that Microfinance Institutions claim to offer solutions to. A gap exists in finding out influence of equity financing on the growth of micro, small and medium enterprises. The poor health of the economy as well as poor relationship between the businesses and financial institutions is among the causes of such a situation. Also, despite the much effort prompted by the government to the informal sector, there is still more that needs to be done so as to heighten the growth of the small and medium enterprises. The department of micro- and small enterprise development estimates that there were close to 2.8 businesses in the year 2002. This number increased drastically within the subsequent years, although a big gap still lies in place. Counties have had had an upsurge of business units in the previous years. However, this factor has not meant the survival of individual business units. The heavy absence of equity financing has also prompted the research into their relationship with the small and medium enterprises (Kilifi Blog, 2015). It is against this background that the study intended to examine influence of equity financing on the growth of micro, small and medium enterprises. A critical literature review.

Objective of the Study

The overall objective of this study was to examine influence of equity financing on the growth of micro, small and medium enterprises.

Significance of the Study

This research will be helpful to the management of small and medium business as it brings out the role of equity financing and performance of small and medium enterprises establishments which will lead to maximization of earnings and cost minimization. The research is expected to create more awareness to all parties and staff engaged in the procedure of equity financing of the recent trends of innovation and how it have influenced on the performance of SMEs. The study findings on the other hand will aid management on decisions about the selection of the best innovations at various developmental stages of the equity financial institutions. Outcomes of the study will be of benefits to research workers and scholars, since it is an area of knowledge and also form a basis for additional research as well as building on the existing body of knowledge and factors out area for further research work. The results of this study will carry value to the government and financial government bodies as it is anticipated to facilitate understanding the reason behind the rapid increase rate of innovations in the equity financing institutions specifically

THEORETICAL REVIEW

The study will benefit from the resource based theory that was proposed by Barney (2001) and the dynamic capability theory of the firm that was proposed by David (1990).

Resource Based View

Barney, Wright and Ketchen (2001) noted that every firm owns a diverse outline of tangible and intangible resources. Barney is one of the late contributors of Resource Based View who studied and established the existence of key firm resources for superior performance. The theory of Resource Based View assumes that individuals are inspired to make maximum use of economic resources available and rational choices that a firm makes which are shaped by economic framework (Barney, 2007). Resource Based View theory in this study played a role of evaluating and explaining resources and capability of a firm that have the capability to create and maintain a firm's advantage and thus higher performance among the mobile phone industries in Kenya (Sheehan & Toss, 2007). Complex packages of skills, obtained knowledge, ability and experience that facilitate the company to manage activities of the firm and make use of resources to create performance through coordinating and putting resources into proper production use is what defines capability (Amit and Shoemaker 1993; Barney, 2007 and Mckelvie and Davidsson, 2009). According to Lockett, Thompsons and Morgensrern (2009) on strategic management, Resource Based View scrutinizes the resources and abilities that facilitate how the firm will produce above the ordinary rates of return and higher performance benefits.

The theory of Resource Based View contributes in enabling the firm managers to check whether factors relevant to superior performance exist or not. This enables them to be in a position of exploiting market imperfection to advance their performance. That way, managers are put in a place where they can combine resources to sustain their performance advantage. Resource Based View theory provides the benefit to the firm specifically highlighting factors that create superior performance for a firm (Locket, Thompson and Morgenstern, 2009). Resource Based View allows executives of the organization to choose the most important strategic factors to invest in from a given range of probable strategic factors in the mobile telephone industry. Barney and Hesterly (2010) advanced that resources in general include the following key constructs: resources, capabilities and competences. In strategic management literature, resources are defined as stocks of accessible things that are possessed by the firm.

Competencies are the firm's strengths that enable it to better differentiate its products or service quality by building technological system to respond to customers' needs, hence allowing the firm to compete more efficiently and successfully than other firms (Defillippi, 1990; Arend and Levesque, 2010 and Anderson, 2011). Resource Based View has contributed in strategic management through its emphasis on firm-specific resources as bona fide source of high performance (Mckelvie & Davidsson, 2009). For a firm to have a superior performance, resources and capabilities have to qualify as exceedingly valuable, rare, inimitable, and non-substitutable. Resources that are valuable add to advancing the firm's performance. Rareness creates ideal competition in view of the fact that resources in that category are possessed by fewer firms. Inimitable resources are costly to duplicate and non-substitutable, meaning that there is no alternative to accomplishing an equal function instantly available to competitors (Barney 2007, Barney and Hesterly, 2010). Tangible resources are physical substances that an organization possesses such as facilities, raw materials and equipment. Intangible resources include corporate brand name, organizational values, networks and processes that are not included in normal managerial-accounting information. Intangible resources are more likely to generate competitive advantage and superior performance as compared to tangible resources (Rouse & Daellenbach, 2009; Kenneth at el., 2011). The study will build onto this study as small and medium enterprise need to use of resources to create performance through coordinating and putting resources into proper production use.

The Dynamic Capability Theory of the Firm

The dynamic capabilities view of a firm, which was launched by David Teece in early 1990s, is based on the works of Barney (2011). The framework is an advancement of the Resource-Based View (RBV) of the firm which views resources as the key to superior organization performance. The dynamic capability theory is based on the concept that organizations will always attempt to renew their resources in a way that suits the changes taking place in a dynamic environment. According to (Teece, Pisano and Shuen 2005), the dynamic capability view examines how firms are able to integrate, build, and reconfigure their specific competencies (internal or external) into new competencies that match changes taking place in a turbulent environment. The theory is based on the assumption that firms with greater dynamic capabilities will always outperform those with smaller dynamic capabilities. Therefore, operations in a dynamic environment call for firms to continuously renew, re-engineer and regenerate their internal and external firm's specific capabilities in order to remain competitive (Barney, 2007). The dynamic capabilities are hard to develop and difficult to transfer because they are tacit and are embedded in a unique set of relationships and histories of a firm. Ordinary capabilities, according to Resource Based View, are about doing things right whereas dynamic capabilities are about doing right things at the right time based on unique processes, organizational culture and prescient assessments of the business environment and technological opportunities surrounding a firm. Strong dynamic capabilities include processes, business models, technology, and leadership skills needed to effectuate high performance sensing, seizing and transforming an organization. The literature review provided a review of past studies on; the business model for small and medium enterprises , the situation for Small and Medium Enterprises in Kenya, and empirical review of the effect of various financial services for example equity financing, provisions of financial literacy, and developments of management skills among Small and Medium Enterprises in facilitation of market network among Small and Medium Enterprises.

Empirical Review

Karuga (2020), conducted a study to that aimed at establishing the effect of micro finance on rural women empowerment in Kikuyu Constituency, Kiambu County in Kenya. The study adopted a descriptive research design with the population consisting of all women groups in Kikuyu Constituency, Kiambu County in Kenya. Findings on the analysis of variance (ANOVA) indicate that the overall model was statistically significant as indicated by an F statistic of 4.863 and p value less than 0.04608. The regression analysis revealed that micro credit to be statistically significant with micro training and micro saving with significance of more than 5% to be not statistically significant. This study provides recommendations clear financial management strategies should be set aside to address key critical financial difficulties facing women particularly developing good financial management technique to provide adequate responses to challenges and problems by focusing on women business processes to minimize claims and enable women growth and women empowerment and have clear framework to advice women on how financial management decisions are made and the procedure to be followed to make sure the right decisions are made to meet the benefit of the customers and maintain their visibility. The study provided a conceptual gap as if focused on establishing the effect of micro finance on rural women empowerment in Kikuyu Constituency, Kiambu County in Kenya while our study will focus on examining influence of equity financing on the growth of micro, small and medium enterprises

Mtawali (2018), conducted a study, to assess the effect of knowledge management on the organizational performance of Microfinance institutions in Kenya. For this purpose, the researcher adopted a descriptive research design where a questionnaire will be used to get responses from 87

Uwezo Micro-Finance bank employees sampled through simple random technique from a total of 111 targeted respondents. In this regard, 62 out of the 87 respondents returned their questionnaires. From the discussion of the key findings, the study made a conclusion that knowledge management practices positively impacted the organizational performance of Microfinance institutions in Kenya. Regarding this, the study concluded that all the independent: knowledge acquisition, knowledge conversion, knowledge application, knowledge protection had a statistically significant positive influence on the organizational performance of Microfinance institutions in Kenya. The study presented a methodological gap as it used descriptive research design while our study will use desktop review method.

Jagongo (2012), conducted a study to investigate the level of awareness, appreciation and acknowledgement among the Kenyan investment community about the role venture capital financing play in boosting industrial development through MSMEs. The study employed a case study methodology that utilized a sample of 106 MSMES out of a target population of 229 MSMES registered in Nairobi Central Business District in Kenya. Data was collected by use of semi structured questionnaire and personal interviews. Descriptive statistics including correlation analysis, ANOVA and measures of central tendencies using SPSS version 19 were employed to determine the variable associations, relationships and dispersion. The main findings were that all entrepreneurship development stakeholders were largely ignorant of the potentials for VCs to bridge the MSME financing gap. The study presented a methodological gap as it was descriptive in nature while our study will be a desktop review approach.

Muchiri (2012), conducted a study that focused on the relationship between interventions by micro- finance programs targeted at women and the socio-economic impacts resulting from these interventions. The sample population was 200 women registered in micro-finance programs within Ongata Rongai area, Kajiado district. Data collection was done through an interview schedule, and analyzed using descriptive statistics. The hypotheses were analyzed using the chi-square test, and the hypotheses that being a member of a micro- finance program significantly increases the level of participation of women in the family decisions, and that being a member of a micro-finance program significantly increases the income opportunities were accepted. The hypothesis that there is a significant relationship between participation in a micro-finance program and increasing awareness of women was rejected. It was concluded that the training employed by the micro-finance programs was effective in creating income opportunities and increasing women's involvement in family decisions but not effective in expanding women's general awareness. The study presented a conceptual gap as it focused on relationship between interventions by micro-finance programs targeted at women and the socio-economic impacts resulting from these interventions while our study will focus on examining influence of equity financing on the growth of micro, small and medium enterprises

Chege (2012), conducted a study to assess the role of micro finance institutions in the growth of micro and small enterprises. The geographical area of study is the Nairobi region as most of the micro and small enterprises are located in this region (K-Rep 1999). The findings of this study revealed that micro and small enterprises that received any kind of assistance from micro-finance institutions had a higher annual growth rate than the average growth rate of the businesses interviewed. The study indicates that micro finance institutions have the potential capability to reach the poor and low income earners. The findings also reveal that besides financial assistance, the MSEs receive a variety of other services from micro finance institutions such managerial and technical assistance including marketing skills. The study presented a contextual gap as it was conducted in the micro finance institutions while our study will be conducted in the small and medium enterprises.

METHODOLOGY

The study adopted a desktop literature review method (desk study). This involved an in-depth review of studies related to influence of equity financing on the growth of micro, small and medium enterprises. Three sorting stages were implemented on the subject under study in order to determine the viability of the subject for research. This is the first stage that comprised the initial identification of all articles that were based on influence of equity financing on the growth of micro, small and medium enterprises. The search was done generally by searching the articles in the article title, abstract, keywords. A second search involved fully available publications on the subject on influence of equity financing on the growth of micro, small and medium enterprises. The third step involved the selection of fully accessible publications. Reduction of the literature to only fully accessible publications yielded specificity and allowed the researcher to focus on the articles that related to in influence of equity financing on the growth of micro, small and medium enterprises which was split into top key words. After an in- depth search into the top key words (influence, equity financing, growth of micro, small and medium enterprises), the researcher arrived at 5 articles that were suitable for analysis. This were findings from:

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SUMMARY, CONCLUSION AND RECOMMENDATIONS

Conclusion

The study further, recommended that equity financing institutions develop and adopt more solid knowledge acquisition initiatives. This would by far impact on human capital development in the organizations what further enhance the organizational performance; the SMEs institutions in to consider doing knowledge mapping and to introduce cross-functional working relations between the employees of the organization to ensure knowledge acquired is converted and put into proper use; the equity financing institutions to consider introducing more formal channels of knowledge sharing within the organization and across the departments such that the employees are able to freely use both new and existing knowledge to solve new or existing problems in the organization; the equity financing institutions to develop and adopt more stringent policies and to ensure all the new employees sign with the company a Non-Disclosure Agreement (NDA) before commencing duty in the organization. This would ensure that this intangible asset stays in the organization

The researcher concludes that MSMEs financed by the venture capitalist that were under study experienced growth in both financial and non- financial aspects as well as in the managerial practices. This study reaffirms the correlation between MSMEs growth in any economy and poverty or lifestyle degradation. The economic impact of venture capitalist has been realized by MSMEs in sales, profit and asset upsurge. The social impact of venture capitalist involvement in MSMEs entail; employment opportunities creation which thus improve the citizen's lives and alleviated poverty in a particular economy. The venture capitalist also leads to increased governments revenue through collection of corporation tax as the MSMEs start making profits. Equity financing involvement has demonstrated that the partnership implicit in equity capital is as important as the finance and that these two aspects of the relationship are mutually reinforcing.

Recommendations

The study recommends that government owned venture capital firms need to be privatized to serve entrepreneurs better. The youth and women development funds which should be venture capital funds but are not as interest is paid by borrowers and no monitoring of businesses should be privatized to become a true venture capital fund to serve young entrepreneurs better. MSMEs using equity financed capital should be given tax concession to attract other SMEs financed by financial institutions. This will open an avenue for their growth after which they will be big industries. This study has shown that the influences of equity financing have been seen and felt and so more businesses should be encouraged to use this type of finance for economic development.

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