



## **Role of Microfinance Institutions on the Financial Performance of Small and Medium Enterprises in Lusaka, Zambia: A Case of Kalingalinga Compound, Zambia**

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### **Abstract**

This study presents an assessment on the contribution of the microfinance loans to SMEs in Kalingalinga Compound. The research was conducted with representative sample of 37 SMEs, 3 MFIs workers and 2 MFIs leaders were randomly selected. The data was collected using different tools such as questionnaires, interviews, documentary review and observation. The findings from the study have shown that there is no progress of SMEs at the enterprise level as claimed by more than 60%, the reasons behind this failure have been attributed to the poor national economy and the borrowers do not inject the capital on the enterprises but on different fixed assets. However, other parameters at household levels, affordability of home needs, ownership of fixed assets and community development support have improved for both MFIs workers SMEs owners. In general MFIs loans despite of the negative impact at enterprise level appear to have positive contribution to the development of the borrowers. Regarding the availability of loans the results have shown that the loans are available but are given upon fulfilling the requirements and at an established increasing rate set by the MFIs. The main challenges facing SMEs in Kalingalinga include lack of sound entrepreneurial skills among the practitioners. Despite of the seminars and workshops organized by the MFIs the skills acquired to the borrowers appeared to be rote and lacking basic skills. Since the members are mostly primary schools level then there is a need of starting entrepreneurship study at primary level throughout to tertiary levels. Poor national economy and frequent inflation were pointed as obstacles to the progress of SMEs, so the government is advised to find the ways of building the stable economy.

**Keywords:** Kalingalinga Compound, SMEs, Zambia.

### **Introduction**

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

Micro finance has for a long time been seen as powerful weapon for sustainable social economic development of economies. The granting micro loans at fair and affordable terms to alleviate financial constraints of the poor households have been recognized by the private sector and public sectors, researchers and other stakeholders (Cedric, 2012; Hugh, 2007). The

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microcredit market sub sector has grown overtime, and by the year 2010, MFIs were able to provide microloans to around 200 million clients and above and about 1 billion persons in developing countries have been able to better their lives due to the microloans. It should also be acknowledged that a lot of micro finance institutions have changed from the social service loans kind of loans delivery to business kind of approach where provision of loans depends on how much profit to be generated and this has been a trend of the past 10 years or so (Cedric, 2012). Bank of Zambia in the year 2012, implemented policy changes in the financial sector and one of them was interest caps on commercial banks at 9.75 percent and 42 percent for on micro finance institutions (World Bank, 2013). It was observed that in the World Bank, 2013 report on Zambia that, by the end of year 2012, financial institutions were able to lend approximately USD 480million to SMEs and only USD 20 million were unsecured and this implies that SMEs in the country would still face a challenge to acquire funding without the right loan security (World Bank, 2013; Feyen and Kibuuku, 2012). The micro small and medium enterprises sector in Zambia has been growing on a phased approach in a sense that, SMEs in the country have always existed in the informal sector and they have overtime been greatly contributing to the economic development of the country (UNDP, 2004). In the country they have been known to employ a large number of people and thus helping to provide income for the households as they are lifted out of poverty and the country continues to recognize that, a clear playing field is vital for the survival and operation of SMEs (UNDP, 2004 and 2006; Zambia development agency, 2015).

The development of the SME sector is critical to the achievement of broader national development goals outlined in the Fifth National Development Plan (FNDP) and in the Vision 2030.

These include:-

- To reduce unemployment levels
- To increase participation of citizens in economic development
- To create avenues for equitable wealth distribution
- To increase utilization and value addition of local raw materials

### **Statement of the Problem**

The Zambian government recognizing the different needs, capacities and constraints faced by the low-income population, developed and adopted a comprehensive Micro finance Policy in 2001, that articulates the roles of various institutions and key players in a sustainable micro finance industry as a strategy for poverty alleviation. Today, it is more than fifteen years of its implementation, but poverty is still critical among the Zambian citizen; so, it is important to assess MFIs impacts on the ground, in relation to poverty reduction.

Poverty reduction initiatives are predominantly government functions. All line ministries are at some level addressing the issues of poverty with the Ministry of Finance and National Planning and Ministry of Community Development and Social Services being the lead ministries in this initiative. Along with other poverty alleviation strategies like Self Help Initiatives, Women's Development Programme, Food for Work, Micro Credit for the Poor, the Child Care Upgrading Programme (CCUP), Public Welfare Assistance Scheme (PWAS), a lot of efforts are being made by government encouraging people to borrow funds and invest on self-employment business as a strategy for poverty alleviation. However, poverty is still a critical problem persisting in Tanzania and other third world countries (Mwaniki, 2006).

Thus, this study seeks to find out the extent at which the MFIs perform the financial linkage by offering satisfactory loans and at right time to the micro and small enterprises or not? Also, if the Microfinance Institutions loans help to improve the micro and small enterprises on one hand and the life standard of the borrowers and workers on the other. The study will also reveal any current problems which hinder the efficient performance of micro and small enterprises activities and thus recommend on the appropriate measures of improving the situation.

### **General Objective**

The general objective of this study is to assess the contribution of microfinance institutions on the economic performance of SMEs in Zambia, particularly Kalingalinga.

### **Specific Objectives**

- To find out if the micro and small enterprises can access satisfactory loans whenever the need arises.
- To examine the contribution of the MFIs loans on the Micro and small enterprises growth inkalingalinga.
- To evaluate the impacts of the MFIs loans on the life standard of the household of the borrowers had before borrowing.

### **Research Questions**

- 1) Do micro and small enterprises secure right amount of loans and at right time?
- 2) Are there any improvements of micro and small enterprises after utilization of microfinance loans and services?
- 3) What are the impacts of the MFIs loans at the household life standard of borrowers?

## **Literature Review**

The purpose of literature review is to enrich the idea of the researcher, refining the research ideas and highlighting awareness of current state of knowledge on topic to show limitation of the study and to illuminate the existing research gap (Gill *et al.*, 1997). It also enables the researcher to compare the findings of the study with other study findings related to the study. The knowledge which is acquired from literatures helps in shaping the study and at the end of the chapter enabling the researcher come up with the research gap.

Zambia is experiencing rapid economic transformation and for this to be sustained the micro financing needs to reach the small investors in all parts of the country and it seems to be getting there as per the policy of the sitting government where it has seen a number of MFIs set up by the public and private sectors for this effect (Bank of Zambia, 2014). According to BOZ, 2104, there are currently 33 MFIs all engaged in Micro financing and they are all registered in Lusaka and their main purpose is financing of SMEs. It is clear research has been done by quite a number of researchers and its virtue has been identified. However, it is vital to research on how micro financing has really impacted on the economies like Zambia and hence the justification for this research. Micro finance institutions are now faced with competition where by its traditional market has now been a target of traditional commercial banks and for that they have to find ways to stay in the market by ensuring most importantly that their customer does not suffer huge costs of financing as was the case in Togo (Kanyurhi, 2013; Bashir *et al.*, 2012; Brafu-Insaidoo and Ahiakpor, 2011). Micro financing plays a pivotal role in poverty reduction in communities and so they should be embraced and this also to say banks need to come up with enabling policy to allow them thrive in society and make them tailor made to beneficiaries demand as done in Nigeria and some other developing countries (Akangbe, Adeola and Ajayi, 2012; UNDP, 2008; Lindsay, 2010). Geographical distribution of MFIs for the purpose of accessibility by the majority rural cannot be underestimated as this will make them economically active and thus contribute to national building of the economy. Micro financing of SMEs needs to be made attractive and appealing to the beneficiaries. This means that MFIs needs to develop cost effective products for the beneficiaries and they also need to use IT and develop e-banking products that can be accessed by for example the rural duels through say mobile phones.

Economies needed to emphasize the development of SMEs as they provide employment and generation of incomes in an economy (Bid Network, 2008). Finance is the life blood of any business and so SMEs cannot be set up if there is lack of finance which the financial institutions and governments can provide at cost or no cost. It is vital to understand that 70 percent of SMEs fail because of poor capital funding in the first two years (Finweek, 2008).

## Research Methodology

There are different methods and techniques that can be used in research depending on the nature and type of research being undertaken. The nature and type of the collected data dictates the type of techniques adopted in collecting scientific data. Saunders (2004) and Kothari (2006) highlight that “when the purpose of the study is accurate description of a situation or of an association between variables then it falls under descriptive studies”. Therefore, fundamentally this research falls under descriptive studies. This chapter is going to present the methods used in conducting this study, the study population, procedures used in data collection, instruments and methods used in the analysis and presentation of data.

### Qualitative Approach

According to Taylor (1998) in Losinyari (2011), qualitative research is form of research that involves description, for example, describing and analyzing the culture and behavior of human groups from those who are being studied. So, it relies on the research strategy that is flexible and interactive. Donald and Trompo (2006) in Losinyari (2011) argue that, this approach is mainly applicable in scientific studies which focus on measurements, which are assignment of numerical events according to rules. The numbers are applied for example gender (male or female).

### Quantitative Approach

According to Karlinger (1986), this approach of research describes as a systematic, control, Empirical and critical investigation of natural phenomenon guided by theory and hypothesis about the presumed relations among those relationships agree with the theories and findings of the previous researches

This study therefore adopts qualitative technique because the researcher intended to explore the economic phenomenon that is the persistence of poverty in third world countries despite of the application different poverty alleviation efforts. This approach has been selected because it helped the researcher to study the area of the study in deep and acquired all the necessary data which was required from the selected cases.

### Research Design

This study adopted a descriptive research design. According to Kelinger (1969) in Komboet *al.* (2006) the major purpose of descriptive is the description of the state of affairs as it exists and may often result in the formulation of important principles of knowledge and solution for the problem. A **cross-sectional case study design** was adopted which is careful study of some social units as a corporation or division within a corporation that attempts to determine what factors led to the success or failure. This design was chosen because it allowed an in-depth investigation of the problem at hand that is persistent poverty in Kalingalinga. district despite of the prevailing microfinance activities for more than ten years. As such the above contention suited this study of MFIs and SMEs as organizations for the purpose of assessing their contribution to the social and economic standard of its clients.

### Area of the Study

The study area selected for the research work is Kalingalinga. Lusaka province of Zambia. Kalingalinga is rural area. The area is chosen because it is easily accessible by the researcher. The second reason is short distance for the researcher and the researcher knows it better. The third reason is that it is a good example of remote areas in the country where most people are still in traditional life style. Kalingalinga established itself as a major commercial Centre. Commercial activity is centred on wholesaling and retailing. Both banking and non-banking financial institutions also offer ancillary services.

### **The Population of the Study**

Saunders (2003) contends a research population as a total group of items from which the sample for research is withdrawn. So, since the research was conducted in Kalingalinga of Lusaka district, then the population for research is all members who have borrowed at least once from the selected case, workers and leaders from the case. The following was the population profile for this study; there were 43 borrowers, 14 workers and management team of 5 members who made the population for this study to be 62 respondents.

### **Types of Data**

**Secondary data** according to Kombo and Trompt (2006) refers to the data collected neither directly by the user nor specifically for the user. The secondary data collection was done from documentary like written documents from Sacco's offices, newsletter and web sites.

**Primary data** on the other side refers to the information gathered directly by a researcher from respondents. This is done to collect the view and the opinion of the respondents directly.

### **Tools of Data Collection**

#### **Questionnaire**

Kombo and Trompt (2006) refers to this as a tool where a set of questions which respondents fill in answers in written form and the researcher collects the forms with the completed information. Multiple items questions were distributed to the respondents. The method was chosen because it was cost effective and less time consuming. The first part of it was the background of the respondent and the second part focused on role of microfinance on economic and social progress.

#### **Interviews**

According to Kombo and Trompt (2006), this method requires the researcher to identify respondents and request them to answer certain questions. Some interviews are carried out through the telephone and the information received is recorded by the researcher. In this study this method was used mostly in data collection whereby open and close ended questions were asked in order to allow interviewees to explain themselves, give further elaboration, more facts and more detailed information. This method was chosen because of its high response rate, less time consuming and its ability to give respondents a chance of giving more opinion. From this method the researcher also got the tone and attitude of the respondent. Telephone interview was applied for the collection of data from Kambashi Fisheries.

#### **Documentary Review**

Kothari (2003) describes these as the data that are available and were collected from secondary sources of data such as journals, books, magazines and research papers. These types of data are normally available for review and analysis in relation to the purpose of the concerned research.

## **Analysis of Data and Interpretation**

### **Introduction**

This chapter presents and discusses about the analysis of the data collected and interprets it for the further views. The analysis is based on three specific objectives namely easiness of accessing loan from SACCOs, the contribution of loan to SMEs growth and the impact of loan to individual members' household standard of living. Models used for analysis includes descriptive statistics and non-parametric models, that is, mean, median and mode. The responses from the questionnaire have been summarized in form of descriptive statistics. Frequency analysis was used to determine whether perceptions were generally shared by the respondents or whether these were isolated view of an individual or few individuals. The findings are presented in the subsequent sections, tables and figures.

### **Analysis and Interpretation**

The data gathered from the survey were obtained through three main ways namely structure questionnaires, interviews and observation of documentary evidence. The questionnaire and interview addressed initially respondents profile in terms of age, duration, gender and status. The other important data gathered from SACCOS's members, were related to specific objectives of the research study. On the other hand specific technical questions were addressed to leaders and loan officers for the purpose of adding firmness of the responses from members. Questionnaires had also general questions which tried to identify the nature and activities which were preceded by the more informed and structured questions targeting to measure all the categories of subject in consideration. Efforts were made to identify critical factors affecting SMEs' progress. The instruments which were used to acquire these data include interview, documentary review and observation. For the interviews respondents views generated have been analyzed through informed methods (Hussey and Hussey, 1997). This requires the data first to be categorized in terms of the specific research objectives that they related to. In addition information generated was assessed in order to ascertain if there were common themes and pattern.

## **Findings, Recommendation and conclusion**

### **Summary of the Findings**

#### **Availability of Loans**

The finding have revealed that there were no problem in getting funds so long the applicants fulfilled the preset procedures claimed by 60% of the respondents. Therefore study concluded that the MFIs perform the presumed function of linking the capital from formal financial institutions down to the marginalized population is fulfilled.

#### **The Impacts of SMEs after Investing the MFIs Loans**

The findings in this study have shown that, generally there is no improvement in terms of an increase in capital, marketing and outreach claimed by 60.5% of the respondents. The researcher was interested to know the opinion from some of the respondents from this group, they said that after completing the repayment the business is almost out of stock, they need to borrow and start again. There were two strong reasons given by the interviewees regarding this anomaly. The first reason is the prevailing poor economic condition resulting to low circulation of money and the second reason is borrower spending loans on purchasing of plots, farms and other fixed assets instead of investing on capital expansion of their businesses.

#### **The Impacts of Loans at Household Level**

The average percent of the social-economic measure parameters show 51.5% of the SACCOs members have admitted to experience improvement this response is slightly more than half. Moreover, the aggregate mean of 2.39 at which is slightly above the acceptable level of 2 suggested that the stakeholders experienced development. On the other hand the workers have all 100% admitted that Sacco's employment has improved their social and economic status.

#### **Ability of Buying Fixed Assets like Farms, Furniture, and Car**

The findings indicate that 26.3 percent of respondents are highly satisfied, 47.4 percent are moderate and remaining 26.3 percent are not satisfied by indicating their rating low. Based on percent indicted highly and moderate satisfaction of 73.7 percent, it can be concluded that member's ability to buy those assets have increased hence indicating that loan has transformed their standard of life.

## Recommendations

### Recommendation to the MFIs

- The MFIs should find the ways to reduce the interest rate for the loan they offer to the entrepreneurs so as to increase the profit margin to the borrowers.
- The MFIs should reduce the long and tiresome procedures when people want to get loans. Although not many, only a few have complained of a delay and long period taken to process the loans which need to be improved.
- The government should ensure that all Zambians possess entrepreneurial education background by introducing the subject/topic in the national education curricula from primary school.
- It is recommended that the introduction should start at as lower grade as possible at least grade four.
- The teaching when an entrepreneur is just about to take a loan has proved to be less effective because the borrowers keep on misusing loans despite of those seminars and workshops.
- The government should strive in strengthening the economy and control the inflation rate as a way of helping the entrepreneurs to grow. Studies have shown that the performance of SMEs depends on the economic condition of the country and the world at large.
- The government should control corruption at any cost. Improve socio-economic situation of the country which will increase money circulation at the national economy.
- The borrowers are advised to utilize the borrowed fund for the proposed aims and not otherwise. They should have prior plan before getting loan and to abide by the initial plan; they should not change their plans upon securing loans. This will enable them to repay the loans and avoiding confiscation of their properties.

## Conclusions

The findings from the study have shown that there is no progress of SMEs at the enterprise level as claimed by more than 60%, the reasons behind this failure have been attributed to the poor national economy and the borrowers do not inject the capital on the enterprises but on different fixed assets, goods and services. However, other parameters at household levels, affordability of home needs, ownership of fixed assets and community development support have improved for both MFIs workers SMEs owners.

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