

INFLUENCE OF SOCIAL CAPITAL ON THE GROWTH OF SMALL AND MEDIUM ENTERPRISES IN KENYA

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ABSTRACT

Social capital refers to the stock of social relations, based on norms and networks of cooperation and trust, that spillover to the market and state to enhance collective action between formal actors and achieve improved social efficiency and growth. Despite the significant role by the SMEs it has continued to experience many constraints like poor access to markets and financial services, lack of innovativeness, poor access to information, unfavorable policies among others that have inhibited the realization of its full potential. The study was guided by the following research objectives which include; finding out to what extent business networks, access to information, access to innovation and access to finance which are components of social capital influence the growth of SMEs in Kenya. The study targeted 4560 SMEs in Nairobi County who are registered by Ministry of Industrialization and Ministry of Trade. The study targeted business owners/ managers/ directors or business partner operating SMEs in Nairobi County. The study adopted descriptive survey and exploratory design. The study employed stratified random sampling, random sampling and convenient sampling to collect data from 456 businesses using questionnaires. Descriptive statistics and inferential data analysis method was used to analyze the gathered data. Regression models were used to examine the influence of social capital on growth of SMEs in Kenya. The study found that social capital components (Business Networks, Access to information, Access to innovation and Access to Finance) have a great positive influence on the growth of SMEs. Business networks are the most significant with correlation coefficient of 97.2% elements of social capital influencing growth of small and medium enterprises in Kenya.

Key Words: *Social Capital, Business Networks, Access to Information, Access to Innovations and Access to Finance*

Introduction

Worldwide SMEs are recognized as engines of growth and development and they are the backbone of the economy in many successful developed nations all over the world.. They have emerged as a vibrant and dynamic component of the economy by virtue of their significant contribution to GDP, industrial production and exports (Dunne & Hughes, 2003). In the world over, SMEs are recognized as one of the most important sources of employment, wealth creation, poverty reduction and contributing to competition with other large businesses. According to World Bank (W.B) SMEs have such a crucial significance in the development of an economy that they can't be ignored hence their development should form one of the objectives of any country (WB, 2002). Available data show that on about a decade ago, SMEs in Kenya employed

3.2 million people and accounted for 18% of national GDP (Woldie, 2008). In view of this, governments globally including Kenya have put a lot of emphasis on the growth of this sector and as a result, in 2011, SMEs contribution to GDP rose up to about 70%, however this sector have continuously remained stagnant in terms of growth and expansion. As vital as they are, SMEs have low survival rate, less than a third of their business survive transition from first to second generation ownership and those that do, about half do not survive the transition from second to third generation ownership (Bowman, 2006). This therefore implies need for intervention and more research on various concepts of their business and operations to enhance their performance in the country.

Statement of the Problem

SMEs play significant role in the economic development by creating employment, wealth creation, poverty eradication and creation of new firms (Musimba, 2012). This sector contributes to about 70% the Gross Domestic Product (GDP) in Kenya (ROK, 2012). In the global economy SMEs are largely recognized as engines of growth and development and are the backbone of economy in many successful developed nations (Zhou, 2007).

SMEs have emerged as a vibrant and dynamic component of the economy by virtue of their significant contribution to GDP, industrial production and exports. The 2012 Enterprise Baseline Survey revealed that there are 17 million Small and Medium Scale Enterprises in Nigeria, employing 32.41 million persons and makes a contribution of about 46.54 per cent to the nation's Gross Domestic Product in nominal terms. In Malaysia SMEs contribute to about 32% to the country's GDP (W B, 2012). According to World Bank (W B) in general, the SME sector can contribute to the GDP of high income countries by as much as 51 percent and the middle and low income countries SMEs can produce up to 39 percent and 16 percent respectively of local GDP (WB,2012). The information on the background of the study reveals SMEs have very low survival rate. The collapse ratio of SMEs is alarming for developing countries as well as developed countries (Hodgetts & Kuratko 2004). Past studies identified that a significant number of new SMEs fail within first five years of their business operation (Zimmerer, Searborough and Wilson 2008; Hodgetts & Kuratko 2004). Sessional Paper No.2 of 2005 (RoK, 2005) and Ministry of Economic planning report on SMEs (RoK, 2007) show that three out of five SMEs fail within their first three years of operation in Kenya . Several studies from Australia, USA and England showed that approximately 80% to 90% of SMEs fail within 5-10 years (Zimmerer et al. 2008; Hodgetts and Kuratko 2004; Ahmad et al. 2011). SMEs in Kenya are evidence of a "missing middle": a shortage of middle - sized growth - oriented SMEs that could make an important contribution to development (Khalique, Shaari, Bin M Isa & Agee (2011). This implies that SMEs in Kenya are threatened for survival as a competitive enterprise. This could result to low economic development and loss of jobs (RoK, 2012).

Would the failure be caused by lack of utilization of social capital by SMEs?

Kirigo (2010) in her study about Factors Affecting Credit Financing of Small and Medium Enterprises in Kenya, indicated that no detailed study has addressed the relationship between social capital and the performance of SMEs and the impact of social network on the overall growth of small enterprises. A study by Musimba (2012) on the Role of Human and Social Capital in Internationalization of ICT SMEs in Kenya concludes that the survival and performance of a firm are influenced by the firm's ability to utilize the social capital to the fullest. He draws attention to how connections and relationships and networking both at home and abroad can be crucially important for small and medium-sized enterprises (SMEs) seeking to export or invest abroad. However, relatively little is known about how SMEs initiate, develop and maintain network relationships. This study therefore seeks to find out whether social capital is a contributor to the performance of enterprises by evaluating the influence of various components of social capital on the growth of SMEs in Kenya.

Objectives of the Study

The overall objective of this was to investigate influence of social capital on the growth of small and medium enterprises in Kenya .Its specific objectives were: a) to establish an influence of business networks as a component of social capital on the growth of SMES in Kenya. b) to find out influence of access to information as a result of social capital on the growth of SMES in Kenya .c) to assess influence of access to innovations as a result of social capital on the growth of SMES in Kenya. d) To establish an influence of access to finance through social capital on the growth of SMES in Kenya

Literature Review

Social capital is the expected collective or economic benefits derived from the preferential treatment and cooperation between individuals and groups. To quote Baron and Markman (2003), 'Social Capital refers to the actual and potential resources individuals obtain from knowing others, being part of a social network with them, or merely from being known to them and having a good reputation.' Entrepreneurs gain a lot of visibility, information, influence and co-operation because of strong social capital. Entrepreneurs progress in their opportunity recognition process with lot of encouragement and support from friends or family members (Davidsson & Honig, 2003). Although different social sciences emphasize different aspects of social capital, they tend to share the core idea "that social networks have vital value in any business (Hazleton (2000). According Baron and Markman (2003), 'Social Capital refers to the actual and potential resources individuals obtain from knowing others, being part of a social network with them, or merely from being known to them and having a good reputation.' These resources include access to information, finance and innovative ideas. Entrepreneurs gain a lot of visibility, information, influence and co-operation because of strong social capital. Entrepreneurs

progress in their opportunity recognition process with lot of encouragement and support from friends or family members (Davidsson and Honig, 2003).

Hazleton (2000) defines social capital as the aggregate of the actual or potential resources which are linked to possession of a durable network of more or less institutionalized relationships of mutual acquaintance and recognition. His treatment of the concept is instrumental, focusing on the advantages to possessors of social capital and the deliberate construction of sociability for the purpose of creating this resource. Access to these resources depends on the relationships one has. There are three ingredients fundamental to social capital: resources embedded within the network, access to these resources through relationships, and the use of the resources for purposive action. Social capital, therefore, is defined 'as resources embedded in a social structure which are accessed and/or mobilized in purposive actions' (Lin, 2001b). This theory of social capital explains how the social network (or the social structure) constraints or enables access to resources embedded within the network. It also states that firms should invest in social capital for future expansion and penetration in new market

Business Networks

Business networking is an effective low-cost marketing method for developing sales opportunities and contacts, based on referrals and introductions - either face-to-face at meetings and gatherings, or by other contact methods such as phone, email, and increasingly social and business networking websites. Because they can significantly help the process of customer acquisition, business networks have received considerable attention in the marketing literature. Although they are less controllable and manageable than marketing actions (e.g., direct mail, broadcast media), referrals have some serious advantages (Kumar et al. 2010; Chen et al. 2011; Trusov et al. 2009). First, their influence on attitudes and beliefs about a firm is much stronger (Villanueva et al. 2008). Information about a product, a service or a firm is indeed considered more credible by potential customers when it is transferred through referrals than when it comes from the firm itself (Anderson et al. 1994; SeEVERS et al. 2010). Second, referrals contribute to customer acquisition at a much lower cost than marketing actions (Trusov et al. 2009). Indeed; they often take place as a result of spontaneous information circulation from one person to the other rather than because of a firm's deliberate efforts. This argument is particularly crucial for SMEs as they tend to have limited resources to dedicate to gaining the attention of potential customers (Golberg et al. 2003).

Access to Information

SMEs need to have access to adequate information to enhance productivity and to facilitate market access. The establishment of an active SMEs sector - and the effective utilization of quality business information - has been identified as crucial in attaining long-term and sustainable economic growth for developed and developing countries, alike (Corps 2005). The SMEs need tailor-made information solutions - i.e., business information services that assess,

verify and apply information to a specific business problem (Okello-Obura... et tal 2008). In order to respond to the specific needs of the SMEs, business information services should create value by bringing together information from different sources - both local and international. This enables the integration of the SMEs into national and global value chains (UNIDO 2005). Okello-Obura ... et tal (2008) argues that there is a need for collaboration between various industrial and trade organizations, professional bodies, private enterprises and government departments to provide SMEs with a comprehensive range of business information, advice and facilities. This implies that the issue of quality information becomes evident.

Access to Innovations

Innovation has long been recognized as an important driver of economic growth (Klomp, 1999) shows that innovation leads to new products and services, better quality and lower prices readily accepted by the customers and other clients. A study by Nas, 1997 exploring the impact of social capital on innovation focused on constructing a more general measure of social capital that consists of generalized and institutional trust, associational activities and civic norms. Social capital has a positive impact on innovation at the national level. Social capital interacts with entrepreneurship; the strongest relationship is between associated activities and entrepreneurship. This study supports the need to build strong social relationships in today's networked economy

Access to Finance

The level of social capital of a community enhances the level of interpersonal trust. This is obviously the case if social capital is the result of moral values imprinted with education. But it is also the case if social capital measures the existence of social networks, which increase the effectiveness of social sanctions. In this case trust is the equilibrium outcome of a society where non-legal mechanism force people to behave cooperatively (Coleman (1990) and Spagnolo (1999)). Indeed, using the General Social Survey data from 1972 to 1994, Brehm and Rahn (1997) and that "the more that citizens participate in their communities, the more that they learn to trust others." Financing is nothing but an exchange of a sum of money today for a promise to return more money in the future. Whether such an exchange will take place depends upon not only the enforceability of contracts, but also the extent the financier trusts the financer. In fact, financial contracts are trust intensive contracts par excellence. Thus, higher level of trust improves the efficiency of financial contracts and increases their use.

Research Methodology

Research Design

In this study descriptive and exploratory research design was adopted. Descriptive statistics and inferential data analysis method was used to analyze the gathered data. It was ideal because the study was carried out in a limited geographical scope and hence tends to be logistically easier and simpler to conduct considering the limitations of this study.

Population

Population refers to the entire group of objects or individuals having common characteristics (Mugenda, 2008). Nairobi County was targeted because it is a commercial centre, it's a cosmopolitan and it's very competitive. Data available from the Ministry of Industrialization and Enterprise Development reveal that there are about 4560 registered SMEs in the manufacturing, trading and service sector in Nairobi County. A list of 4560 enterprises sourced from the Ministry of industrialization and Enterprise Development was used as the sampling frame.

Sample and Sampling Technique

This is the list of ultimate sampling entries which may be people households, organizations or other units. (Mugenda, 2003) it is the physical representation of the target population and comprises all the units that are potential members of a sample (Kothari, 2004). Due to the big size of the population; it was not possible to study all elements of the population. Sampling was done in stages and the businesses were stratified into sectors as follows; Trade, service sector and manufacturing, and from each stratum 10% of the members were randomly selected. The convenient and random sampling techniques were employed. According to Mugenda and Mugenda (2003), convenient sampling is a technique that involves selecting cases or units of observation as they become available to the researcher. It is also referred to as accidental or volunteer sampling. It was used because subjects are easily and conveniently available and are accessible. Random sampling was used to pick subjects from each stratum to compliment the convenient sampling.

Data Collection Instruments

Data collection is the means by which information is obtained from the selected subjects of an investigation (Kothari, 2008). Both primary and secondary data were used for this study. The research study used questionnaires as a key instrument for data collection.

Data Analysis and Presentation

Descriptive statistics was used to analyze the data. It enabled the researcher to meaningfully describe distribution of scores using statistical measures of central tendencies, dispersions and distribution (Mugenda, 2008) it was presented in pie charts, percentages and tables. Correlation statistical procedure will be used to generalize the results from the sample population.

Results and Discussion

Business Networks

The study sought to investigate the influence of business networks as a component of social capital on the growth of small and medium enterprises. Specifically, the study focused on business referrals and social networks. 28.6 % of the respondents indicated that business referrals

influence the growth of SMEs to a very great extent, 18.2% indicated that business referrals influence the growths of SMEs to a great extent, 26.8 % indicated that business referrals influence the growth of SMEs to a moderate extent, 17.5 % indicated that business referrals influence the growth of SMEs to a low extent while 8.9 % indicated that business influence the growth of SMEs to a very low extent.

The findings relate with those of Kumar et al (2010) who found out that although they are less controllable and manageable than marketing actions (e.g., direct mail, broadcast media), referrals have some serious advantages (Kumar et al. 2010; Chen et al. 2011; Trusov et al. 2009). 27.9% of the respondents indicated that social networks influence the growth of SMEs to a very great extent. 23.2% of the respondents indicated that social networks influence the growths of SMEs to a great extent. 24.3 % of the respondents indicated that social networks influence the growth of SMEs to a moderate extent, 15.4 % of the respondents indicated that social networks influence the growth of SMEs to a low extent while 9.2 % of the respondents indicated that social networks influence the growth of SMEs to a very low extent. The findings relate with the findings of Zontanos and Anderson, (2004) that social networking allows businesses to gain access to resources that might otherwise not be available to them.

Access to Information

The study sought to investigate the influence of access to information on growth of Small and Medium Enterprises in Kenya. Specifically, the study focused on institutional co operations and knowledge exchange. 28.9% of the respondents indicated that institutional collaborations influence the growth of SMEs to a very great extent, 25% of the respondents indicated that institutional collaborations influence the growth of SMEs to a great extent, 22.9% of the respondents indicated that institutional collaborations influence the growth of SMEs to a moderate extent, 15.7 % of the respondents indicated that institutional collaborations influence the growth of SMEs to a low extent, While 7.5 % of the respondents indicated that institutional collaborations influence the growth of SMEs to a very low extent. Institutional collaborations is one of the factors that influence the growth of firms which should be taken into consideration by the SME owners. The findings relate with the findings of Okello-Obura et al (2008) that there is a need for collaboration between various industrial and trade organizations, professional bodies, private enterprises and government departments to provide SMEs with a comprehensive range of business information, advice and facilities. 23.2% of the respondents indicated that knowledge exchange influence the growth of SMEs to a very great extent, 27.8% of the respondents indicated that knowledge exchange influence the growth of SMEs to a great extent, majority 26.2% of the respondents indicated that knowledge exchange influence the growth of SMEs to a moderate extent, 12.9 % of the respondents indicated that knowledge exchange influence the growth of SMEs to a low extent, While 10 % of the respondents indicated that knowledge exchange influence the growth of SMEs to a very low extent. Therefore knowledge exchange as a result of social capital is one of the factors that influence the growth of firms which should be taken into consideration by the SME owners.

Access to Innovations

The study sought to investigate the influence of innovativeness on growth of small and medium enterprises in Kenya. Specifically, the study focused on new product development and opportunity recognition. 27.9 % of the respondents indicated that new product development influence the growth of SMEs to a very great extent, 25.7% of the respondents indicated that new product development influence the growth of SMEs to a great extent, 23.6 % of the respondents indicated that new product development influence the growth of SMEs to a moderate extent, 15.7% of the respondents indicated that new product development influence the growth of SMEs to a low extent, while 7.1 % of the respondents indicated new product development influence the growth of SMEs to a very low extent. These findings concur with the findings of Varis and Littunen (2010) who found that introduction of new products in comparison to the revenues of enterprise is a major significance to SMEs growth and competitiveness. 25% of the respondents indicated that opportunity recognition influence the growth of SMEs to a very great extent, 23.9 % of the respondents indicated that opportunity recognition influence the growth of SMEs to a great extent, 26.4 % of the respondents indicated that opportunity recognition influence the growth of SMEs to a moderate extent, 15.4% of the respondents indicated that opportunity recognition influence the growth of SMEs to a low extent, while 9.3 % of the respondents indicated that opportunity recognition influence the growth of SMEs to a very low extent. Earlier studies from India suggest that the size of network and number of weak ties significantly affect the number of opportunities recognized by entrepreneurs (Singh et al., 1999), meaning social interaction increases knowledge acquisition of opportunities.

Access to Finance

The study sought to investigate the influence of Access to Finance as a component of social, capital on growth of small and medium enterprises in Kenya. Specifically, the study focused on access to credit and cost of financing. 26% of the respondents indicated that access to credit influences the growth of SMEs to a very great extent, 31% of the respondents indicated that access to credit influences the growth of SMEs to a great extent, 18% of the respondents indicated that access to credit influences the growth of SMEs to a moderate extent, 11% of the respondents indicated that access to credit influence the growth of SMEs to a low extent while 25% of the respondents indicated that access to credit influence the growth of SMEs to a very low extent. The study findings relate to those of Nguyen & Ramachandran (2006) find that building close social relationships with financial institutions enables SMEs to get preferential access to credit over their competitors and, hence, employ more debt, especially short term debt, in their capital structure. They also demonstrate the stronger the level of networking with other firms, the greater the debt employed by SMEs in their capital structure. 37% of the respondents indicated that cost of financing influences the growth of SMEs to a very great extent, 7% indicated that cost of financing influences the growths of SMEs to a great extent, 18 % indicated that cost of financing influences the growth of SMEs to a moderate extent, 28 % indicated that

cost of financing influences the growth of SMEs to a low extent, while 9% indicated that cost of financing influences the growth of SMEs to a very low extent. These findings concur with those of Preliminary work on the relationship between social capital and capital structure has been conducted in the United States (Uzzi, 1999) and Vietnam (Nguyen and Ramachandran, 2006). Uzzi (1999) demonstrates that, when their transactions are embedded in social relationships and networks, firms are able to gain better access to bank financing at a more competitive prices.

Regression analysis and Correlation coefficients of growth of SMEs

The study found out that access to finance as a component of social capital is positively correlated with growth of SMES as indicated by a correlation coefficient of 0.643. Further the matrix indicates that access to innovations as a component of social capital is strongly and positively correlated with growth of SMES as indicated by a correlation coefficient of 0.719. The correlation matrix indicates that access to information as a component of social capital is strongly and positively correlated with growth of SMES as indicated by a correlation coefficient of 0.862. Business networks showed the highest correlation with the growth of SMEs as indicated by a strong correlation coefficient of 0.972

The study conducted a multiple regression analysis so as to determine the relationship between the growth of SMEs and the components of social capital (Business Networks, Access to information, Access to innovations and access to finance. According to the equation, taking

The regression equation ($Y = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \epsilon$) was interpreted to mean

$$Y = \beta_0 + 1.654 X_1 + 0.988 X_2 + 0.568 X_3 + 0.444 X_4 + \epsilon$$

According to the equation, taking all factors (Networks, access to information, access to Innovations and access to finance) constant at zero, overall Social capital on the growth of SMEs will be 3.657. The data findings also show that a unit increase in business referrals will lead to a 1.654 increase in growth of SMEs; a unit increase in Access to information will lead to a 0.988 increase in growth of SMEs; a unit increase in Access to innovations will lead to a 0.568 increase in the growth of SMEs and a unit increase in access to finance will lead to a 0.444.

At a 5% level of significance and 95% level of confidence, business networks had a 0.002 level of significance, access to information showed a 0.005 level of significant, access to innovation showed 0.013, access to finance had a 0.032 level of significant, hence the most significant factor is business networks.

Conclusions and Recommendations

The finding of the study revealed that there is a significant positive relationship between the components of social capital namely Business Networks, Access to Information, Access to Innovations and Access to Finance

Results of the inferential statistics such as ANOVA show that Business Networks, Access to information, Access to innovations and access to finance which are component of social capital has a major positive significance contribution to the growth of SMEs in Kenya

The study recommends that entrepreneurs should establish strong business networks which are an important element of social capital that entails establishing a solid stock of connections, interactions, relationships, linkages, closeness, goodwill, and loyalty between a firm and its customers, downstream clients, strategic partners or other external stakeholders as this has a positive and significant influence on the growth of SMEs in Kenya.

Entrepreneurs should realize that in the access to information, access to innovativeness and access to finance which are components of social capital influence the growth of SMEs .Social capital enhances the accessibility of these resources and should there be embraced.

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