THE EFFECT OF MICRO FINANCE INSTITUTIONS SERVICES ON THE FINANCIAL PERFORMANCE OF MICRO AND SMALL ENTERPRISES IN NDIA DIVISION

BY

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DECLARATION

I declare that this research is my original work and has not been submitted for a degree in any other university.

Signed …………………………………… Date ……………………………………...

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D61/60105/2010

This research project has been submitted for examination with my approval as university supervisor.

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ABSTRACT

Micro finance institution in Kenya offer loans, savings services and other financial services to small and medium enterprises and individuals. Microfinance institutions in Kenya operate through opening branches, traditional groups, Point of sale Devices (POS) and mobile banking.

The study attempted to establish how the micro finance services affect financial performance of small medium enterprises either positively or negatively. This is because the easier it is to access credit, the higher the financial performance of the small medium enterprises.

The study found that accessibility and repayment of Loans affects financial performance of MSEs positively. The easier it is to access repay Loan, the higher the financial performance of the MSEs. The study also found that increase in sales positively affects financial performance of Micro and small enterprises. The two variables under the study were not significant to the financial performance of the MSEs. This is because they explained only 72.8% of SMEs' financial performance.

The research therefore recommends that government and other policy makers should enhance more accessibility and availability of micro credit for increased profitability and growth of MSEs. Also recommends that governments and central banks should work together for lower interest rates. The researcher suggests that further studies should be done to establish other factors that account for the 27.2% change in financial performance of MSEs.

DEDICATION

I dedicate this project to the Almighty God for enabling me to complete this research. To my loving Mother Joan Lucy Wanjiku Mathenge who is my inspiration in everything I do, and for her encouragement as she made me who I am today, also to my friends for their moral support.

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LIST OF ABBREVIATIONS

ASCAs - Accumulating Savings and Credit Associations

GOK – Government of Kenya

MFIs – Micro Finance Institutions

RLF - Revolving Loan Fund

ROSCAs (Chama) - Rotating savings and credit associations

SACCOs - Savings and credit cooperative societies

SMEs - Small and microenterprises

CHAPTER ONE

1.0 INTRODUCTION

1.1 Background of the study

In Kenya, despite emphasis on increasing the availability of credit to micro and small enterprises (MSEs), access to credit by such enterprises remains one of the major constraints they face. A 1995 survey of small and microenterprises found that up to 32.7% of the entrepreneurs' surveyed mentioned lack of capital as their principal problem, while only about 10% had ever received credit (Daniels et al, 1995).

Commercial banks and other formal institutions fail to cater for the financial needs of micro and smallholders, however, mainly due to their lending terms and conditions. It is generally the rules and regulations of the formal financial institutions that have created the myth that the poor are not bankable, and since they can't afford the required collateral, they are considered uncreditworthy (Adera, 1995). Hence despite efforts to overcome the widespread lack of financial services, especially among smallholders in developing countries, and the expansion of credit in the rural areas of these countries, the majority still have only limited access to bank services to support their private initiatives (Braverman and Guasch, 1986).

Experience from informal finance, shows that the rural Micro and small enterprises often have greater access to informal credit facilities than to formal sources, (Hossain, 1988; Schrieder and Cuevas, 1992; Adams, 1992). The same case has also been reported by surveys of credit markets in Kenya (Raikes, 1989; Alila, 1991; Daniels et al, 1995).

This study is aimed at empirically analyzing the credit policies in the rural financial markets with the view of establishing their role in determining the access of financial services to micro and small-scale.

1.1.1 Microfinance

Microfinance started as a general term describing financial services to low-income individuals or to those who do not have access to typical banking services. Microfinance is also the idea that low-income individuals are capable of lifting themselves out of poverty if given access to financial services. While some studies indicate that microfinance can play a role in the battle against poverty, it is also recognized that is not always the appropriate method, and that it should never be seen as the only tool for ending poverty. Today microfinance institution (MFI) is used as an organization that provides microfinance services which range from small non-profit organizations to large commercial banks (http://cgap.org).

The modern microfinance movement started with a focus on microcredit in many countries and

Microfinance institutions (MFI's) play a key role in many developing countries. They serve as important providers of credit to Micro and Small enterprises borrowers and thus can play a significant role in programs to alleviate poverty and promote economic opportunity in nations around the world (Morduch 1999, Zohir and Matin 2004).

Deposit taking micro finance business means a microfinance business in which the person conducting the business holds himself out as accepting deposits on a day-to-day basis, or any other activity of the business which is financed, wholly or to a material extent, by lending or extending credits for the account and at the risk of the person accepting the deposit, including the provision of short-term loans to small or micro enterprises or low income households and characterized by use of collateral substitutes (The Microfinance Act, 2006).

These institutions give loans to borrowers who seek relatively small amounts and who may be viewed as too risky by larger conventional lenders. Quite often, MFIs operate with subsidies from charitable or governmental agencies (Caudill et al, 2009).

Access to financial services such as saving and borrowing of funds to Micro and Small enterprises management have increasingly been regarded as an important tool for raising and prudently managing the incomes of the Micro and Small enterprises, and hopefully reducing the poverty level by supporting entrepreneurship and encouraging the society to be more self-reliant and independent. Despite efforts to overcome the widespread lack of financial services, especially among smallholders in developing countries, and the expansion of credit in the rural areas, the majority still have only limited access to bank services to support their private initiatives (Braverman and Guasch, 1986).

Although microfinance has been practiced around the world for hundreds of years on an informal basis, its contemporary origin lies in Europe, where formal savings and credit arrangements began to appear in the eighteenth century. By the early nineteenth century, Fredrich Wilhelm Raiffeisen had begun establishing community-owned financial cooperatives in Germany. His aim was to improve the welfare of the rural population and sever its dependence on moneylenders by providing an alternative source of financial services. From the 1860s onward, the financial cooperative model spread rapidly across

Europe, North America and the developing world, expanding access to financial services for the world's urban and rural poor (Friedrich Wilhelm Raiffeisen, 2006).

Access to financial services by smallholders is normally seen as one of the constraints limiting their benefits from credit facilities. However, in most cases the access problem, especially among formal financial institutions, is one created by the institutions mainly through their lending policies. This is displayed in the form of prescribed minimum loan amounts, complicated application procedures and restrictions on credit for specific purposes (Schmidt and Kropp, 1987).

Schmidt and Kropp (1987) further argue that the type of financial institution and its policy will often determine the access problem. Where credit duration, terms of payment, required security and the provision of supplementary services do not fit the needs of the target group, potential borrowers will not apply for credit even where it exists and when they do, they will be denied access.

The concept of Micro financing can also be traced back to an obscure experiment in Bangladesh 30 years ago by Yunus the founder of Grameen Bank. It has since become a worldwide movement as a development activity, as a way of helping poor people out of poverty (Dicher, 2006).

Buckley (1997) captures their prominence role in development of economies; he describes them as the newest darling of the donor community. Other authors have described them as the newest silver bullet for alleviating poverty (Karmani, 2007) while Greer (2008), Gupta and Aubuchon (2008) claim that microfinance shines as a proven way to improve the lives of the poor.

Traditionally, banks had not considered poor people to be a viable market. This failure of commercial banks to cater for the credit needs of smallholders as a result of the myth that the poor are not bankable since they can't afford the required collateral as per the rules and regulations of the commercial banks and are therefore considered not credit worthy, has underlined the importance of a needs oriented financial system for Micro and Small enterprises development (Adera, 1995).

These institutions make loans to borrowers who seek relatively small amounts and who may be viewed as too risky by larger conventional lenders. Quite often, MFI operate with subsidies from charitable or governmental agencies. (Caudill et al, 2009).

1.1.2 Ndia Division

Ndia is a division of Kirinyaga district in Kenya's central province. Its location on the slopes of Mount Kenya means that it has fertile volcanic soils and good rainfall. Indeed, the first Report on poverty in Kenya suggests that when rains are good then there is no absolute poverty in Kirinyaga district (government of Kenya, 1998).

Ndia Division has four Locations, first, the locations of Mukure and Kiini in the tea zone; second, the locations of Mwerua and Kariti in the coffee zone; the tea and coffee zones are divided by altitude, with tea doing well on the cooler upper slopes, and coffee requiring the warmer lower slopes of Mount Kenya (Author, 2011).

Ndia's financial markets, has wide range of financial service providers in Ndia including banks and non-bank financial Institutions (nbfis), savings and credit cooperative (saccos), mfis, and informal sources of provision such as rotating savings and credit association (roscas), accumulating savings and Credit association (ascas) and moneylenders. The formal financial sector which includes banks and nbfis, two of the five main banks with a national presence operate in this area Kenya commercial and equity bank (Author, 2011). The failure of many government-subsidized credit programmes to reach the targeted groups has prompted the emergence of alternative means of administering rural credit so as to reduce the access problem (Braverman and Huppi, 1991). Informal credit markets have developed in rural areas, providing faster services to their clients. That informal finance is more important than formal finance has been proven by different approaches used to measure its magnitude in different countries, namely Chipeta and Mkandawire (1992) for Malawi and Aryeetey and Gockel (1991) for Ghana. Important lessons can be learned from the success of informal financial institutions.

1.2 Research Problem

The Kenyan government recognized the importance of microfinance sector in the nation's financial community, since the beginning of May 1999. To this effect many studies have been done on microfinance elsewhere as regards to the effect of MFIs services on financial performance of MSEs, but nothing much has been done on the same in Ndia Division. Kiiru (2007) carried out a study in makueni district on microfinance, entrepreneurship and rural development, and found significant (though weak) positive impact of microfinance on household income. Although Microfinance plays a pivotal role in provision of microfinance services, approaches to regulate MFIs are complicated since they operate under different legal structure Owino (2005).

According to Macharia (2005), MFIs have have been accepted as the single most effective strategies for delivering the poor out of poverty, in Kenya many are still living in poverty. Mokogi (2003), observed that formal and informal credit sources in Kenya have been mainly qualitative in nature. (Reikes, 1989; Alila, 1991; Aleke Dondo, 1994; Daniels et al, 1995).

Zeller (1993, 1994) used the individual characteristics where he observed that their decisions are only affected by internal factors. However, external factors also play an important role in influencing participation in credit markets.

Nagarajan et al. (1995) observed that estimates of loan demand are often biased because they use models that do not adequately correct for selectivity bias or they use data that do not account for the existence of multiple loans.

Packer (1993), states that MSEs requires finance to enable them make payments for the services, licence fees, working capital required, and as business capital both initial capital and additional capital to be injected in the business. Working capital normally account for 55% and 11% is is used to finance fixed assets (Oketch and Kioko 1995). Techniques of provision of credit to MSEs has been observed by yoder (1993), to be changing from time to time for instance it has been observed that MFIs in Kenya uses grouping of client in order to attain economies of scale from small scale to transactions where they institute small group guarantee methods.

Many MSEs in Kenya are financed by microfinance institutions yet Reike (2001) finds that savings acts as means of determining who to give credit and how much to give. The borrower is required to accumulate saving both prior and during borrowing which enables the borrower to pledge such savings as collateral, however this seems to contradict the micro finance lending logic because the borrower may not necessary have ability to save.

Reike (2001), still contends that access to future larger loans should be dependent on the punctual and full payment of the initial loan. Owing to their important role in the social economic benefits MSEs financial performance holds the key to economic social – cultural through capital injection. However the many studies done so far, none of them has been done to establish the effect of microfinance in Ndia Division. This state of affairs leads us to pose the question; what effects does microfinance institutions services have on the financial performance of Micro and Small enterprises in Ndia Division?

1.3 Research Objectives

The main objective of this study is to assess, the extent to which microfinance institutions have improved the financial performances of micro and small enterprises. The specific objective is to: Determine the effect of microfinance institutions on financial performances of micro and small enterprises in Ndia.

1.4 Significance of the Study

The study is of greater importance as it can be used to expand the provision of financial services and to come up with regulations and policies to regulate Microfinance institutions (MFI's) on suitable products the micro and small enterprises, so as to improve the growth of Micro and Small enterprises. The study is also important to scholars who find it useful in providing information on the Impacts of micro finance financing on financial performance of Micro and Small enterprises in Kenya as it provides basis upon which further studies will be carried out.

This study will help to investigate and assess the role of the institutional lending policies of formal and informal credit institutions in determining the access to and use of credit facilities by Micro and Small scale entrepreneurs in Ndia, as this will help to analyze the factors that determine the participation of entrepreneurs in credit markets and their choice of credit sources in Ndia. It will also identify the main features of the lending policies of formal and informal credit institutions that determine the access to and use of credit by micro and small scale entrepreneurs, which will help to draw policy implications for financial services to micro and small scale enterprises in Kenya.

The researcher beliefs that the findings of this study will add to the scarce literature on microfinance especially in rural areas, the body of knowledge on microfinance will also be enriched by the contributions of the findings of the study. Also other researchers could build on the findings of the study to carry out further research in the area to confirm, improve, expound, update or enrich the finds of this study.

CHAPTER TWO

2.0 LITERATURE REVIEW

2.1 Introduction

The chapter reviews the past literature on the subject under the study, by looking at theoretical review on, microfinance financing of MSEs, empirical review, conceptual framework, conceptualization and operational framework. Finally a reflection is put into the review of the empirical studies on the subject of microfinance services and their impact on financial performance of MSE's.

2.2 Theoretical and Conceptual Framework

Many authors have written extensively with regards to various approaches that can be used as research. In view of this, Holme and Solvang (1991) argued that, quantitative and qualitative are the two research methods that could be applied in research work.

Bryman (2004) also explained the use of quantitative method as a research approach with regards to deductive approach. According to Bryman (2004), this method focuses on the quantification in the gathering and analysis of data and a deduction made between theory and the research. Bryman (2004) arguments were further backed by Saunders et al (2003) who explained that deductive approach usually develops a theory and hypothesis and a research strategy is designed to test the hypothesis and a research strategy is designed to test the hypothesis. However, Holmes and Solvang (1991) stated that this particular method is applied when conducting a statistical research.

Bryman (2004) further explained that, qualitative research develops a research approach and focuses on the use of inductive approach. According to Bryman (2004), the inductive approach compares the relationship between theory and the research with emphasis made on generation of theories. With regards to the various approaches explained, it is therefore necessary to indicate that qualitative method will be applied for this research work. This is due to the fact that in order to fully comprehend what organizations are doing and could do to improve management control. Therefore, the research would be conducted qualitatively in a case study form.

The poor households are the main participants in some kind of informal sector ranging from small petty trading to medium scale enterprises (Jean-Luc 2006). And due to the fact that this sector uses intensive labor force and as well since it is the livelihood of most of the poor, developing this sector argued to be a weapon to resolve the problem of unemployment and poverty of a household (Lakew 1998 and Jean-Luc 2006).

Several studies noted different causes for poverty in a country. Some argued that the cause of poverty in developing economies among other things is that the poor does not have access to credit for the purpose of working capital as well as investment for its small business (Jean-Luc 2006).

To this end many developing economies have developed and have been providing credit to the poor through microfinance schemes. The experience of several Asian, African as well as Latin American countries could be a typical example for this (Meyer 2002).

In this study, data will be collected on all loans from different lenders available to the borrowers. To achieve the stated objectives, the study will use both descriptive and analytical methods. These include cross tabulations, tests of differences between the means, and analysis-of-variance (ANOVA).

2.3 Theories

2.3.1 Theory of Financial Intermediaries

Traditional theories of intermediation are based on the transaction costs, and asymmetric information, diamond and dybvig (1983). They are designed to account for institutions which take deposits or issue insurance policies and channel funds to firms. However, in the recent decades there have been significant changes. Although transaction costs and symmetric information have declined, intermediation has increased.

The information asymmetries generate market imperfections, i.e. deviations from the neoclassical framework. Many of these imperfections lead to specific forms of transaction costs. Financial intermediaries appear to overcome these costs, at least partially. (Pyle 1971) interpreted financial intermediaries as information sharing coalitions. Another approach is based on diamond and dybvig (1983) they said banks are considered as coalitions of depositors that provide households with insurance against idiosyncratic shocks that adversely affect their liquidity position.

Diamond show that these intermediary coalitions can achieve economies of scale and also act as delegated monitors on behalf of ultimate savers, Monitoring will involve increased returns to scale, which implies that specializing may be attractive. Individual households will delegate the monitoring activities to such a specialist, i.e. to the financial intermediary. The households will put their deposits with the intermediary. They may withdraw the deposits in order to discipline the intermediary in his monitoring function. Furthermore, the will positively value the intermediary's involvement in the ultimate investment (Halt, 1995).

The relevant transaction costs consist of search, verification, monitoring and enforcement costs, Benston and Smith (1976). The financial intermediaries act as coalitions of the individual lenders or borrowers who exploit economies of scale or scope in the transaction technology. The notion of transaction costs encompasses not only exchange or monetary transaction costs but also search costs and monitoring and audit costs, Benston and Smith (1976).

The role of the financial intermediaries is to transform particular financial claims into other types of claims called qualitative asset transformation. As such they offer liquidity (Pyle, 1971) and diversification opportunities, Hellwig (1991). The provision of liquidity is a key function for savers and investors and increasingly for corporate customers, whereas the provision of diversification increasingly for corporate customers, whereas the provision of diversification increasingly is being appreciated in person and institutional financing. According to Diamond and Rajan (2000) financial intermediaries are active because market imperfections prevent savers and investors from trading directly with each other in an optimal way.

2.3.2 Economic Theory

Some economists refer to entrepreneurs as agents of change; they consider entrepreneurs as the fourth factor of production, the factor that combines other factors of production namely; capital, land and labour in a profitable manner. They explain that economic environment forces people to create opportunities to start enterprises. They also say that those that find themselves economically disadvantaged e.g. unemployed, displaced and the poor sometimes start their enterprises to solve their own problems. When an economy is growing, it creates more opportunities for businesses as the demand for various commodities like food, houses and information go up. According to Kent (1981) for one to be an entrepreneur he/she most likely would have had an association or a relationship with an entrepreneur. It holds that exposure to entrepreneurship breads entrepreneurship.

2.3.3 McClelland Theory of Motivation

It is the most commonly used psychological theory in explanation of entrepreneurship. David McClelland of Harvard University through a series of researches identified various characteristics of successful entrepreneurs .the theory suggests that entrepreneurs are motivated by three different needs which include; Achievement/success, Affiliation and Power (Baumol, 1990).

According to the theory achievement is a desire to perform in terms of a standard of excellence or to be successful in situations. He was also of the opinion that high achievement differentiates themselves from others by their desire to do things better. Person with high motivation seeks situations where he /she can attain personal responsibility. They enjoy future challenges and novel activities; they hate succeeding by chance and are competitive (Baumol, 1990).

2.4 Microfinance Loans to Micro and Small Enterprises

Micro and Small Enterprises are vital in promoting economic growth, competitiveness, entrepreneurship and innovation, and in creating new jobs. Ensuring adequate access to finance so that Micro and Small Enterprises can grow and achieve their full potential is central to achieving the objectives of the renewed Lisbon partnership for growth and jobs.

Kauffmann (2005) suggests that securing suitable financing remains an obstacle for Micro and Small Enterprises, especially for the growth of innovative Micro and Small Enterprises, whose technology and business models are not understood by many more traditional financial institutions and start-up enterprises and very young firms, which lack a track record and collateral against which to raise debt finance (Cousin, 2007).

Traditionally Micro and Small Enterprises have been financed to a great extent by internal sources both from the business owner and through retained profit. Many Micro and Small Enterprises also need external sources of finance. Here, a distinction can be made between informal sources, such as family and friends, and some types of business angel investment, and more formal sources such as bank loans, followed in order of relative importance by leasing, trade credits and factoring. Venture capital and funds of business angels are only important for a select group of high potential Micro and Small Enterprises like seeders/start-ups, gazelles and management buy-outs and buy-ins (Staley and Morse, 1965).

Bank loans are the most important source of external finance. Problems with bank loans occur because of a lack of a track record, inadequate security, breach of a threshold limit and a credit rating outside an acceptable range. Close firm bank relations help to receive long term bank loans. Leasing and factoring might ease financial problems. By leasing the cash flow improves and Micro and Small Enterprises do not need to finance an investment at once.

2.5 Empirical Review

Microfinance institutions provide small-scale financial services to poor people who are otherwise "exclude from the formal banking sector" (Morduch, 1999) and standard financial systems. Operation merely in developing and emerging countries, they have specialized in offering loans of minor scale to enable individuals to start small productive business and enhance entrepreneurship. Especially in rural of developing counties, the development of financial systems is often poor; sometimes they have not full emerged at all. In this case, microfinance institutions often represent a first opportunity for the local population to participate in financial systems and to benefit from access to business and capital.

Brau and wallore (2004) review over 3500 articles studies on microfinance institutions (MFIS) on their impact on both economic growth and society. The review includes section on sustainability of MFIs where they site many studies concluding that institutional sustainability is necessary goals as subsidized loan funds generally are more fragile and less focused. Just as Yunus knows that these subside distort the incentives in the microfinance others have argued that subside undercut the effective and scale of operation.

Abremas and von stafferberg (2007) conclude that an increase in international support of microfinance by development institutions is "crowding out provide" investment development agencies are supporting is the largest and most successful MFIs increasing their scale, and discouraging support the largest and most MFIs incasing their scale and discouraging support of these institutions that should be time limited and rule-bound " otherwise an institution could be sustainable using standard measures but vulnerable to completion form new source of credit. As the economic area in which the clients of the institution operate grows of credit.

As the economic area in which the clients of institution operate grows new lenders are likely enter. The data reported here shows that the greater subsides do lead to greater scale. However, we must also control for the benefits a microfinance institution may receive from changes in the overall economic conditions of the country in which they operate.

Khander (1996) has a review of many Grameen and further looks at its impact and sustainability. One import conclusion in that study was than higher growth to reduce poverty sustainable basis microfinance institutions alone are not subsidy level in microfinance institutions rating agencies. The author states that ‘’the government thus has an important role to play in promoting and sustaining economic growth to reduce poverty on a sustainable basis’’. Microfinance institutions alone are not what will sustain the micro entrepreneur.

Hudon and Traca (2006) find that a higher subsidy level in microfinance institutions is associated with lower sustainability. The authors note that the sample is not representative in that these rated institutions are more likely to have achieved sustainability, having already achieved operational scale. The study also did not control for overall economic activity. The study conducted here addresses these two issues by using both new and established institutions across many countries and controlling for economic activity in the country.

Strong (2008) in his research titled “beyond microfinance: Entrepreneurial solutions to poverty alleviation’’ concluded that although microfinance has become extremely popular as approach alleviation, there are still controversies associated with it. For instance, he urged that microfinance is primarily used for debt and consumption rather than investment in revenue generating in the same effect.

Copestake (2002) argues that microfinance has a polarizing effect as there is discrimination in favor of richer clients, who benefit from better access to credit, and exclusion of poorest people. He adds that if one of the aims of microfinance is to assist the ‘’poorest of the poorest’’ the microfinance is not always the most appropriate intervention. Micro and Small-sized Enterprises (SMEs) make a significant contribution to the socio-economic and political infrastructure of developed and developing countries as well as the nations in transition from command to market economies (Matlay and Westhead, 2005).

Furthermore, a healthy and growing SME sector is perceived to be crucial for sustainable competitive advantage and economic development at local, regional and national levels (Porter, 2006). In turn, Harper (1998) notes that ‘‘the relative and absolute importance of small enterprises has grown enormously over the last twenty years; this real growth has been matched by appreciation of their role. What were previously regarded as temporary stepping stones to real business is now recognised as one of the most vital contributors to people’s incomes and to development, however they may be defined”.

According to Westhead and Wright (2000), the absence of adequate funding represents a major obstacle to the entrepreneurial process in a firm – regardless of size, location or type of economic activity. Some “life style” entrepreneurs can satisfy their small firms' financial needs by requesting loans from their families, friends or acquaintances (Hussain and Matlay, 2007). Typically, however, the vast majority of growth oriented SMEs rely on long-term funding made available by banks, financial institutions or venture capitalists (Donckels, 2000; Mason and Harrison, 2000; Manigart and Sapienza, 2000).

Importantly, when the cost of survival or growth strategies in these firms exceed the availability of financial resources owned and controlled by owner/managers, they become dependent on the availability of external sources of finance. In most industrially developed and developing economies, a growing number of SMEs need access to a wide range of sources of finance. Arguably, well-functioning capital markets could facilitate access to finance, promote entrepreneurship and enable growth oriented businesses to operate profitably and make a significant contribution towards employment and economic stability.

It is suggested that SMEs, through their inherent advantage of size and flexibility, have the ability to engage in product, service and knowledge innovation, respond rapidly to new opportunities, diversify their operations and contribute significantly to net job creation (Garvan and O'Cinneide, 1994). Informal and small-scale lending arrangements have long existed in many parts of the world, especially in the rural areas, and they still survive.

Good examples are schemes in Ghana, Kenya, Malawi and Nigeria ("merry-go-rounds", "esusus" etc.). They provide the rural population with access to savings within the local area and with a certain cushion against economic fluctuations, and they encourage a cooperative and community feeling. The groups formed provide joint collateral and serve as instruments for spreading valuable information that is useful for economic and social progress (Nafukho, 2007).

Stoke and Wilson (2006) argues that all economies rely upon the financial intermediary function to transfer resources from savers to investors. In market economies, this function is performed by commercial banks and the capital markets. More widespread financial intermediation, as well as increasing depth and variety, is a hallmark of advancing development. But in many developing countries, capital markets are still at a rudimentary stage, and commercial banks are reluctant to lend to the poor largely because of the lack of collateral and high transaction costs.

The poor would borrow relatively small amounts, and the processing and supervision of lending to them would consume administrative costs that would be disproportionate to the amount of lending. Holt (2004) agrees that in many developing countries, overall interest rates are relatively high to begin with, so that rates charged by micro lending schemes are quite high when the risk premium is added.

Many of these micro-institutions claim a high rate of repayment. This is attributable to the informal participatory structures, which create an atmosphere in which debtors respect their obligations. While this phenomenon is certainly true of the better-run institutions, it is not possible to verify whether this is a universal feature. There is little by way of "global" research in this area, even though the literature on micro credit has proliferated in recent years. In addition, the administrative structures governing these institutions are commonly either fragile or rudimentary, and often involve large transaction costs.

A study by the Organization for Economic Cooperation Development (OECD, 2005), for example, found that many specialized agricultural institutions were not designed to serve as financial intermediaries. The success of financial intermediation at any time depends significantly on how efficiently the transaction is completed. If the transaction costs, combined with high interest rates, require that the operation in question generate profit margins of the order of 30 to 50 per cent, it is not clear that this would be economically beneficial. It is not surprising that in many micro lending operations, trading activity - with quick turnover and large profit margins – dominates (Katz, 2003).

In many cases, micro credit programmes have been stand-alone operations. There is now considerable consensus that lending to the poor can succeed provided it is accompanied by other services, especially training, information and access to land. An OECD study, for example emphasized that credit needs to be supplemented with access to land and appropriate technology. But such activities require strong support from the public sector. In some of the lowest-income countries, lack of access to land is the most critical single cause of rural poverty, which dominates the poverty situation in those countries. Yet, few countries have substantial land reform programmes (Rabbior, 1990).

Moreover, in the proliferation of micro lending institutions, non-governmental organizations and foreign donors have played an increasing role. Non-governmental organizations vary in quality and strength. The best results are produced, research shows, when developing country Governments and non-governmental organizations work hand in hand. While donor participation can be positive, it should be noted that total official development assistance (ODA) has declined in recent years.

The Office for the Special Coordinator for Africa and the Least Developed Countries also participated in the Sixth International Women Entrepreneurs Conference, held at Accra from 16 to 19 September 1997. The theme of the conference was "Technology and communication on women entrepreneurs in the global economy". The Office will also be participating in the Second Tokyo International Conference on African Development, which will deal with the issue of rationalizing the micro credit concept in Africa and developing a model that could be applied throughout the African region. With regard to publications, the Office carried out a study on poverty eradication in 14 selected countries, describing experiences of innovative efforts in addressing poverty and underdevelopment (Holt, 2004).

Finding start-up finance for the business is the biggest hurdle that many entrepreneurs go through. Even after getting started, getting sufficient finance to sustain business growth and financially stable is another problem. Research findings by McCormick et al (1996), Daniels et al (2003) Kinyanjui (2006) show how SMEs are constrained by finance. A study undertaken by Kiiru, Mirero and Masaviro (1988) for Kenya Rural Enterprise Programme (K-Rep) confirms that a major constraint within the small business enterprise sector is financing.

In the study carried in Nairobi among small manufacturing enterprises, Nyambura (1992) established that finance was rated among the biggest problem. In South Africa Eeden (2004) finance was also cited as one of the most prominent constrains. The problem related to finance includes lack of information on where to source for finance, restrictive lending offered by commercial banks, lack of access to finance, insufficient financing, lack of track record required by the banks, limited access to collateral, and the fact that financial institutions lack appropriate structure for dealing with SMEs.

As a result of scarcity of finance, small enterprises are unable to expand, modernize or meet urgent orders from customers. The profit margins are usually little to support growth. Harper (1984) notes that businesses like grain millers and tailors are unable to compete with large manufactures of ready-made goods because they have to wait until a customer provides them with raw material or money to buy it. Some may be unable to get started until a customer pays the deposit, which will be used to buy the raw material.

Capital is therefore necessary for the long-term survival and growth of small enterprises. It should also be noted that more money than required can be much of a problem as less money. More money means high cost for money in terms of interest and may also lead to un-worthwhile investments.

The Kenya government’s policy for industrialization and commerce soon after independence in 1963 was geared towards expansion of overall output focusing on large scale enterprises Aleke Dondo (1989). According to this policy, the assumption was that only through such enterprises could contribute towards growth. It was however realized much later in the 1970’s that the large enterprises were not growing fast enough to solve unemployment problems.

Attention was thereafter focused on small enterprises. The government policy before and thereafter has not been very favorable to the small enterprises. Harper (1984) observes that governments that are concerned with the promotion of small enterprises should examine the impact of its policies and programmes on the small businesses.

Mann et al (1989) makes similar observation that government regulation about wages, taxation, licensing and others are among the important reasons why informal sector business develops. “Without careful attention, government policies could crush the small business sector of any economy” (Strauss, 2006).

It is therefore the government’s responsibility to ensure that its policies are helping and not hurting enterprises, creating conditions for the small business to flourish. Licensing, permits and business regulations for instance are major challenges facing small enterprises. While commenting on the need to slash some council licenses Ministry of Trade and Industry P.S, David Nalo observes that many costly permits hamper private sector growth and competitiveness. Some permits and licenses exist for historical reasons while others exist for reasons that are no longer valid.

Harper (1984) also identifies inappropriate standards and legally imposed regulations, which apply to product specification, buildings and environment as some of the other problems facing small entrepreneurs. He notes that such standards are adapted from industrialized countries and for big enterprises hence inappropriate for the small business sector. Taxation has also been ranked high as a source of regulatory cost and disincentive for small businesses in South Africa. According to the article, the tax laws are incomprehensive and complicated to the small businessperson.

Small enterprises sometimes find it easier operating outside the law because of the cost and cumbersome regulations unsuitable for their operations. Compliance for such regulations is costly and beyond their capacity. Some of the small business operators prefer operating outside the formal system. This according to Kinyanjui (2006) is hindering the small sector growth and financial stability.

A study carried out by kiiru (2007) in makueni district using experimental case study design and by the inclusion dynamics in the analysis, this study found significant (though weak) positive impact of microfinance on the improvement of households' income. It reasserts that important component of development of household income it reasserts that providing affordable financial services to the rural population still remains to be an important component of development strategy. In particular the study cautions that the ability of households to begin informal sole micro entrepreneurship should not be assumed to be adequate for the improvement of household income.

Studies by (Kithinji, 2002), shows that the Kenyan government in the beginning of May 1999, recognize the nation's financial community. As in march 1999 the government formed the Association of microfinance institutions (AMFI).

2.6 Summary of Literature Review

The researcher seeks to establish the impact of micro finance services on the financial performance of micro and small enterprises' in Ndia division. The above mentioned theories and empirical reviews are highly linked to this study, as the MFIs are providing loans to the micro and small enterprises thus increasing their income and mobilizing their savings.

The researcher will endeavor to establish and find out how the standard of living of these micro and small enterprises owners have been improved since joining the microfinance institutions, by better quality of education for theirs children and good health among other things.

CHAPTER THREE

3.0 RESEARCH METHODOLOGY

3.1 Introduction

This chapter highlights on the research design and methodology of the research study used in gathering information, how it was designed and presented. In addition, it illustrates the area of examination with regards to those interviewed. Furthermore it also describe why Ndia division was chosen, sources of literature, techniques employed in data collection, research purpose, data analysis as well as critiques to the method used.

Therefore, I analyzed information received from Ndia Division which enabled me to satisfy my purpose. This entails the methods and procedures that assisted me in identifying the sources of data, the sampling method used the sampling design and sample size, data collection methods techniques, instruments and procedures used, data analysis, interpretation and presentation.

3.2 Research Design

The data collection process required a preliminary survey in order to construct the sampling frame and draw a sample. The researcher applied a descriptive research design. Descriptive research involved field survey where the researcher went to the population of interest to ask certain issues about the problem under the study. The design used to obtain information concerning the current status of the phenomena to describe what exists, with respect to financial performance of the MSEs in question.

The study was aimed at giving more information on a given variable and shows relationship between the variables. Descriptive research aims to gather data without any manipulation of the research context, where the researcher has got no control over the variables (Mugenda and Mugenda, 1999).

3.3 Target Population

A population of small-scale enterprises in agricultural and non-agricultural activities was identified in the study region. This included both credit and noncredit users. Since there was no official register of individual entrepreneurs operating in this area, it was not possible to have a list of the traders. Respondents were randomly selected from this population in the selected markets using a random start. A sample size of 40 respondents was targeted and distributed as follows: Mukure 10, Kiini 10, Mwerua 10 and Kariti 10.

3.4 Sample

The researcher used purposive sampling to select the owner of each enterprise; the reason for this was that the owner was deemed to have in-depth knowledge of the subject under the study. Systematic random sampling was used to pick subsequent respondents. The entrepreneurs were used to identify the available informal sources of credit from which they had benefited. This was necessary in order to avoid the problem of sample selection bias and also the possibility of informal lenders not known in the formal system. According to Mugenda and Mugenda (2003), a representative sample is one that is at least 10%-20% of the population of the micro and small business owners.

3.5 Data Collection

According to Yin (1994), six sources of evidence could be used in conducting a research method which is as follows: documentation, archival records, interviews, direct observations, participant-observation, and physical artifacts. Eriksson & Wiedersheim paul (1999), emphasized that when a case study is carried out, the researcher has the possibility to collect data from same methods mentioned above. However, the above sources of evidence can be classified into two: Primary and secondary form data collection.

The study used mainly primary data from individual entrepreneurs and farmers receiving credit from both formal and informal financial institutions as well as those who did not. The formal financial institutions considered in this study were commercial banks, non-bank financial institutions, savings and credit cooperative societies (SACCOs), and development financial institution, mainly. Informal finance has been used to refer to all transactions, loans and deposits occurring outside the regulation of a central monetary or financial market authority (Adams and Von Pischke, 1992; Aryeetey and Udry, 1997).

The informal financial institutions in this study consisted of rotating savings and credit associations (ROSCAs), savings and credit associations (SCAs), mutual assistance groups (MAGs), relatives and friends, welfare associations, shopkeepers, traders, and community-based organizations and NGOs. The primary data was collected by administering structured questionnaires to the sampled respondents. Data collection involved gathering of information relevant to the research study. The survey was carried out in Mukure, Kiini, Mwerua and Kariti.

Small-scale entrepreneurs engaged in farming, wholesale and retail trade and primary processing of agricultural products were selected as the units of study. Rural-based enterprises were selected mainly because surveys on microenterprises in Kenya have shown that about 78% of the enterprises are located in rural areas (Parker and Torres, 1994). Further, up to 64% of all credit to micro and small-scale enterprises have gone to those enterprises located in rural areas (Daniels et al, 1995).

The researcher will use primary sources to collect data for this study. The primary data will seek due to its nearness to truth and ease for control over errors (Copper and Schindler, 2003). By administering questionnaires, with closed ended and open-ended questions to the sampled respondents. A structured questionnaire was used to collect the data from the respondents; the questionnaires were administered by drop and pick method was used to distribute them. Open questionnaires were used so as to get diverse view of the entrepreneurs subjected to the process. A specimen of the questionnaire is available at appendix.

3.6 Data Analysis

Miles and Huberman (1994) emphasized on two strategies for analyzing data: these are within case analysis and cross case analysis. Within case analysis is said to be the only kind of strategy that a researcher goes within the case and compares it to previous research. However there can be more than one case, the researcher can use a cross-case strategy for data analysis, thereby comparing one case to the other. For the purpose of this research within case analysis was applied to empirical data, by collecting from interviews since within-case analysis can provide a more clear representation of the interview data of the reader's understanding, so that the interview data answers the research questions and purpose and thereby making comparison on within case with previous research. By finding out what micro finance institutions are doing, and suggest effective ways of implementing management control and make recommendations.

Primary data collected was coded, analyzed regressed with the help of the Statistical Package for Social Sciences (SPSS) version 18 and Microsoft Excel. The analysis used descriptive statistics such as mean scores and standard deviations. Other statistics such as the inferential statistics was also used to analyze the data. The results was presented using tables, graphs and charts for ease of understanding.

Tables and graphical presentation presented the data collected for ease of understanding and analysis. In determining the relation between variables, the study used multiple regression Analysis method. With multiple regression analysis method it is possible to express the model used in studying the relation between leverage ratio and variables to examine (Gujarati, 1999).

$$\mathbf{Y} = \boldsymbol{\beta_0} + \boldsymbol{\beta_1}X_1 + \boldsymbol{\beta_2}X_2 + \boldsymbol{\varepsilon}$$

Y= Financial performance of Micro and Small Enterprises (MSE's) – (Dependent Variable)

$X_{1,}$ X_2 – Independent Variable

β_0= is the Constant term

$\beta_{1,}$ $\beta_{2,}$ = is the regression co-efficient associated with $X_{1,}$ X_2 respectively

X_1= Increase in Sales Volume of Micro and Small Enterprises (MSE's)

X_2= Loan Repayment capacity by the Micro and Small Enterprises (MSE's)

ε = error term.

CHAPTER FOUR:

4.0 DATA ANALYSIS, FINDINGS AND DISCUSSIONS

4.1 Introduction

The research objective was to establish the effect of the micro finance institutions services on the financial performance of micro and small enterprises in Ndia division. This chapter presents the analysis and findings with regards to the objectives and discussion of the same. The findings are presented in percentages and frequency distributions means and standard deviations. Tables and charts have been used to present the findings.

4.2 Characteristics of the Respondents

A total of 40 Questionnaires were issued out. The complete questionnaires were edited for completeness and consistency. Of the 40 questionnaires issued, all were returned. This represented a response rate of 100%.

4.3 Loan Repayment Capacity

4.3.1 Source of Initial Capital

Most of the owners of Micro and Small enterprises started their businesses from their personal savings. In this survey, only 8 owner got loans from micro finance institutions to start their businesses with. The table below shows the Source of Initial Capital of micro and small enterprises business owners.

Source of Initial Capital

	Frequency	Percent %	Cumulative Percent %
Personal Savings	31	77.5	77.5
Friends and Relatives	1	2.5	80
Loans froms MFIs	8	20	100
Total	40	100	

Table 4.1 - Source of Initial Capital

4.3.2 Years in Business

Most Micro financial institutions take in to consideration the age of a business before granting the Loans. Most of them will not give a loan to a business when it is starting. In this survey, only 4 businesses were less than 1 year old. The table below shows the Years the owner has been in Business.

Years in Business

Years	Frequency	Percent %	Cumulative Percent %
Less than 1 Year	4	10	10
1-2 Years	9	22.5	32.5
3-5 Years	13	32.5	65
6-10 Years	7	17.5	82.5
Over 10 Years	7	17.5	100
Total	40	100	

Table 4.2 - Years in Business

4.3.3 Process and cost of applying for credit facilities

For the purpose of this survey, the process was associated with the cost of accessing Loans which was defined as all the costs before the applicant got the money i.e. cost of collecting collaterals, loan processing fee, inspection fee etc. The researcher asked whether business owner felt that this process was Very satisfied, Satisfied, Very dissatisfied and dissatisfied. Table 4.4 below shows that a 47.5 %, which is a combination of respondents who said Very satisfied and satisfied. The remaining 52.5 % said that the process is Very dissatisfied and dissatisfied, this shows that a simple majorly feel that the process is difficult.

Degree of Satisfaction on Procedure of Obtaining the Loan

	Frequency	Percent %	Cumulative Percent %
Very Dissatisfied	5	12.5	12.5
Dissatisfied	15	37.5	50
No opinion	1	2.5	52.5
Satisfied	15	37.5	90
Very Satisfied	4	10	100
Total	40	100	

Table 4.3 - Degree of Satisfaction on Procedure of Obtaining the Loan

4.3.4 Reasons for not being granted the Loan

Most of the businesses interviewed had taken a loan from a financial institution. However some indicated that they had applied for financing for at least more than once and in some instances the loans were not granted. The following are some of the reasons they gave as to why the loans were not granted. Though only 2 businesses had an experience of not being given loans, the above reasons are an indication of why other MSE's may not be able to access finance.

Reasons for not being granted the Loan

	Frequency	Percent %	Cumulative Percent %
High interest Rates	1	50	50
Collateral/Security	1	50	100
Total	2	100	

Table 4.4 - Reasons for not being granted the Loan

4.3.5 Source of Loan for business owners

The main objective of this survey was to assess the effects of the micro finance institutions services on the financial performance of micro and small enterprises in Ndia division. For this objective, it is important to understand the sources of the Loans for the MSEs. The table below shows some of the common financial organizations where small businesses owners access Loans from in Ndia Division.

Half of the sample had accessed credit from a Micro Finance Institution (20 - 50%), second is Banks which 30% of the respondents reported to have got loans from, ROSCA, SACCO, RLF and Friends and Relatives also play a significant role in the provision of these services.

Source of Loan for business owners

Where do you Borrow your Money for business	Frequency	Percent %	Cumulative Percent %
Micro Finance Institution	20	50	50
Banks	12	30	80
Rotating Savings and Credit Association (ROSCAs) - Chama	2	5	85
Savings and Credit Cooperatives (SACCOs)	2	5	90
Revolving Loan Fund (RLF)	2	5	95
Friends and Relatives	1	2.5	97.5
Others	1	2.5	100
Total	40	100	

Table 4.5 - Source of Loan for business owners.

4.3.6 Period taken to receive the Loan after Application

After applying for Loan, it is the wish of the applicant that they get the money as soon as possible so as to utilize it. This survey sought to understand the time it took to get the Loan for the different people who had applied for the Loan. Results in table 4.6 show that a total of 27.5% had accessed the Loans in about 5 days. The majority 20% had to wait for a week while 14 out of 40 respondents (35%) said they had actually to wait for more than 2 weeks.

Period taken to receive the Loan after Application

	Frequency	Percent %	Cumulative Percent %
1-2 Days	4	10	10
3-5 Days	7	17.5	27.5
One Week	8	20	47.5
1-2 Weeks	7	17.5	65
More than Two Weeks	14	35	100
Total	40	100	

Table 4.6 - Period taken to receive the Loan after Application

4.3.7 Opinion on the Period Taken to Process the Loan

In such cases where a business has to wait for the funds for 3 weeks had dare consequences in some cases. For instance, once asked for their opinion on the time it took, table 4.7 below shows that only 9 (22.5%) felt that time was shorter than expected, a further 37.5% said that they expected it to be that long while 17.5% said it was longer and (22.5%) very long than expected.

Opinion on the Period Taken to Process the Loan

	Frequency %	Percent %	Cumulative Percent
Shorter than Expected	9	22.5	22.5
The Expected Time	15	37.5	60
Longer than Expected	7	17.5	77.5
Very Long	9	22.5	100
Total	40	100	

Table 4.7 – Opinion on the Period taken to receive the Loan after Application

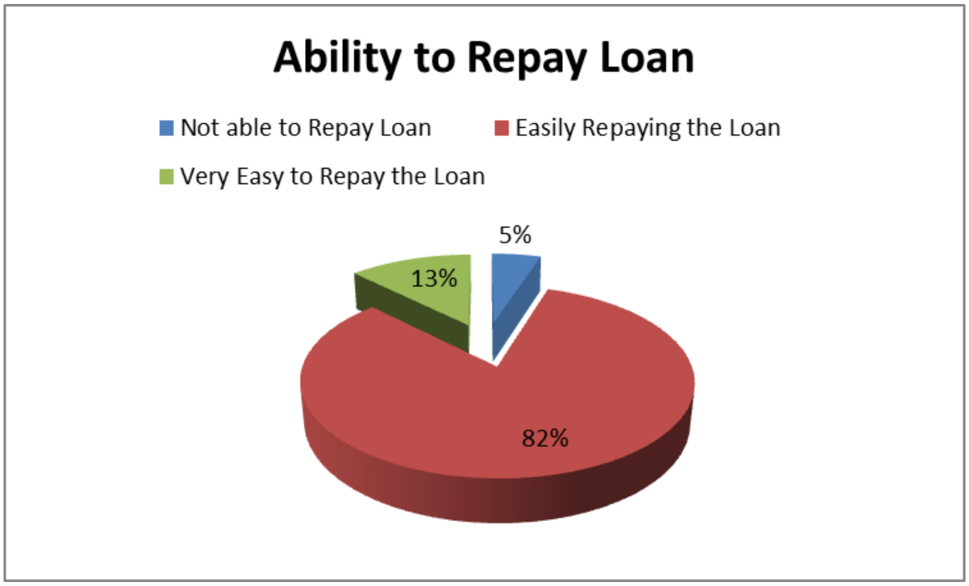
The expectations clearly show that these business people would have wanted to have the money earlier than it was provided. A cross tabulation of the time it took and the opinion of the respondents on the loan shows that most of the respondents would be happy with getting the funds within a week of less than that.

4.3.8 Ability to Repay the Loan

Most of the businesses interviewed were able to repay back the Loans taken from a financial institution. However some indicated that they were not able to repay back the loans. Though only 2 (5%) businesses had experienced difficulties will paying the loans, all the others 38 (95%) were easily or very easily able to repay the loans.

Table 4.8: Ability to Repay Loan

	Frequency	Percent %	Cumulative Percent %
Not able to Repay Loan	2	5	5
Easily Repaying the Loan	33	82.5	87.5
Very Easy to Repay the Loan	5	12.5	100
Total	40	100	



4.3.9 Interest Rate Charged on the Loan

While asking the questions, interest was defined as the amount of money one paid for taking the loan. The respondents were asked to share their expectations; if they were very satisfied, satisfied, No opinion, satisfied and very satisfied by the interest rate charged on the loans. Table 4.8 show that only 57.5% said that they were either very dissatisfied interest or dissatisfied with the interest charged on the loans. This is an indication that these business people feel the interest rates are too high but it's manageable.

Degree of Satisfaction on Interest Rate Charged on the Loan

	Frequency	Percent %	Cumulative Percent %
Very Dissatisfied	8	20	20
Dissatisfied	15	37.5	57.5
No opinion	1	2.5	60
Satisfied	14	35	95
Very Satisfied	2	5	100
Total	40	100	

Table 4.9 - Degree of Satisfaction on Interest Rate Charged on the Loan

4.4 Increases in Sales Volume

4.4.1 Increase in Sales Volume due to availability of cash flows from Loans

The main objective of this survey was to assess the effects of the micro finance institutions services on the financial performance of micro and small enterprises in Ndia division. For this objective, it is important to understand the increase in sale volume due to availability of Loans for the MSEs. From the table below only 9 (22.5%) had not seen any increase in sales of their business.

Increase in Sales Volume due to availability of Cash flows

	Frequency	Percent %	Cumulative Percent %
No	9	22.5	22.5
Capital Access leads to meeting customer Demand	3	7.5	30
Bought more Goods/Stocks/Inventories/Inputs to Sell	28	70	100
Total	40	100	

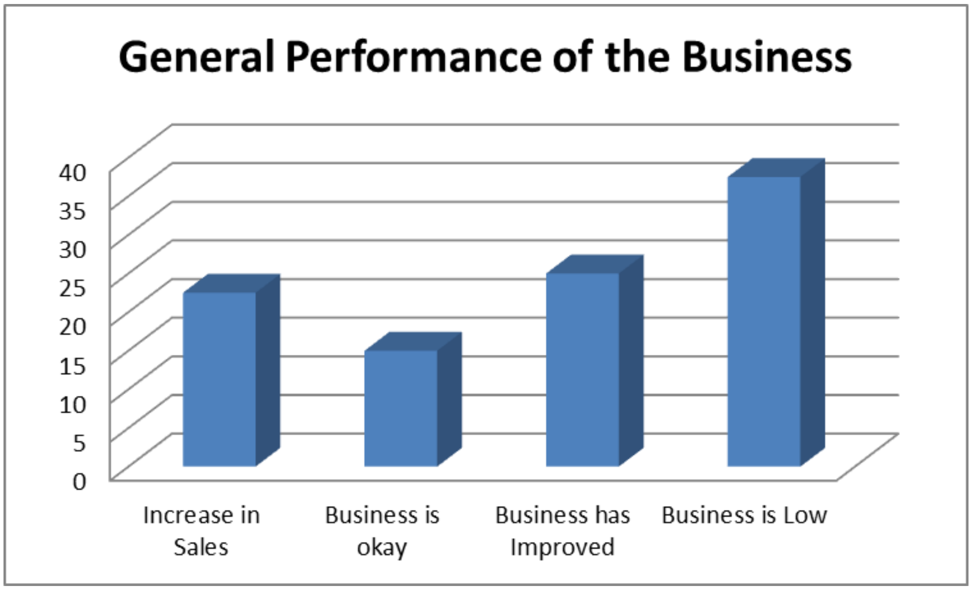
Table 4.10 - Increase in Sales Volume due to availability of Cash flows

4.4.2 General Performance of the Business

This can further be explained by the following table which shows that only 15 (37.5%) respondent believed business was low, and the other 25 (62.5%) believe that the availability of loans has led to better performance of their business.

Table 4.11: General Performance of the Business

	Frequency	Percent %	Cumulative Percent %
Increase in Sales	9	22.5	22.5
Business is okay although the high cost of living	6	15	37.5
Business has Improved/Running Smoothly	10	25	62.5
Business is Low	15	37.5	100
Total	40	100	

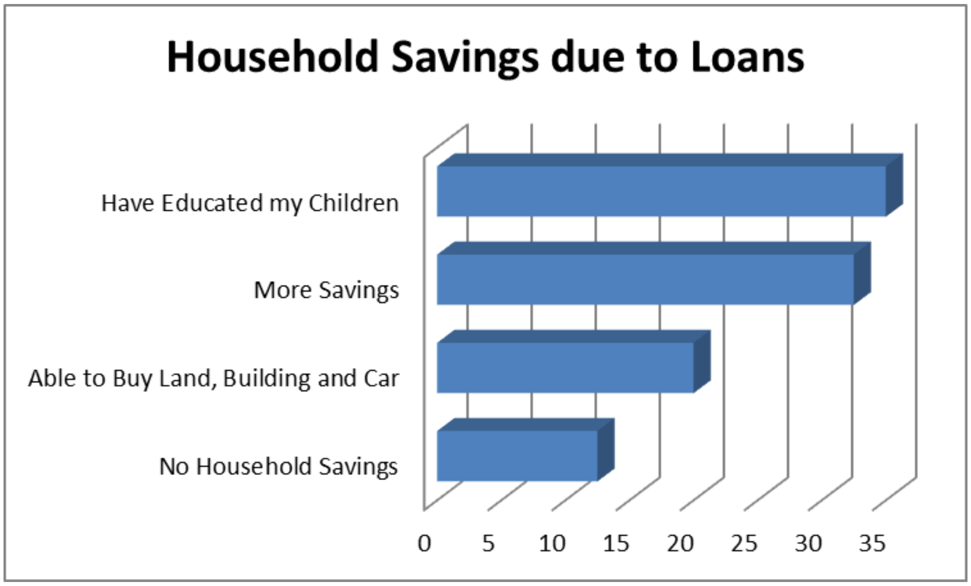


4.4.3 Household Savings due to Availability of Loans

this can be explained by the table below as we can see due to the increase in sales 35 (87.5%) the owner of micro and small enterprises have been able to buy property, save more, or educate their children and only 5 (12.5%) did not save.

Table 4.12: Household Savings due to Loans

	Frequency	Percent %	Cumulative Percent %
No Household Savings	5	12.5	12.5
Able to Buy Land, Building and Car	8	20	32.5
More Savings	13	32.5	65
Have Educated my Children	14	35	100
Total	40	100	



4.4.4 Increases in Number of Employee due to Growth

While asking the questions, the respondents were asked about how growth in their business due to availability of loans had made them to expand and increase on the number of employees and on how many more employees they had employed. Table 4.9 shows that only 80% said that they had either employed one or two more employees, this is an indication that these business people feel their business had grown.

Increases in Number of Employee due to Growth

No. of Employees	Frequency	Percent %	Cumulative Percent %
1	26	65	65
2	6	15	80
3	5	12.5	92.5
4	1	2.5	95
5 and Above	2	5	100
Total	40	100	

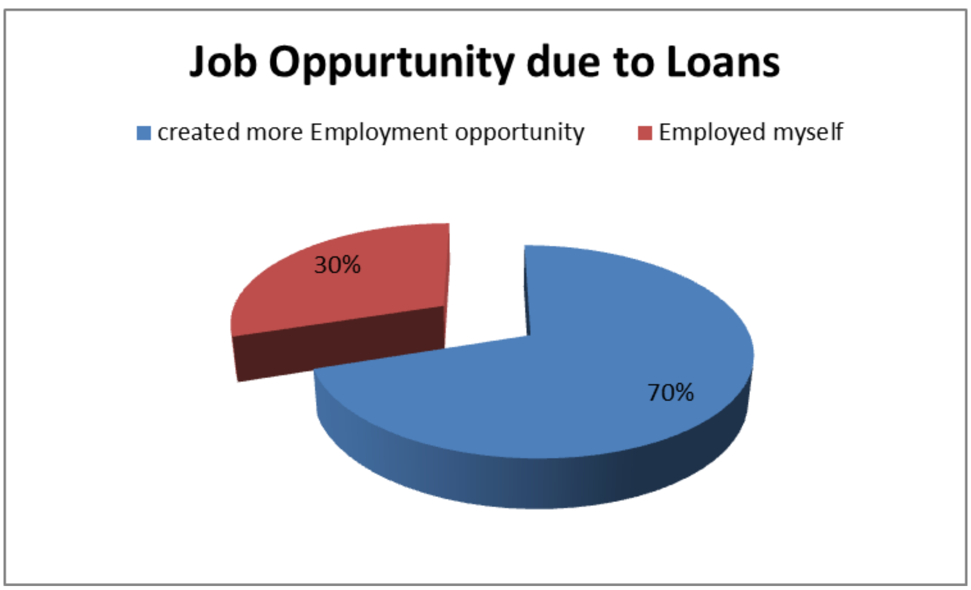
Table 4.13 - Increases in Number of Employee due to Growth

4.4.5 More Employment Opportunities due to Loans

The owner of the micro and small enterprises feels that there is more employment opportunity due to availability of loans, as 30% have been able to employ themselves while 70% have created job opportunity for other people.

Table 4.14: More Employment Opportunities due to Loans

	Frequency	Percent %	Cumulative Percent %
created more Employment opportunity	28	70	70
Employed myself	12	30	100
Total	40	100	



4.5 Regression analysis

This is a statistical technique that is used to predict behavior of dependent variables with a set of independent variables. Regression analysis is used for the investigation of relationships between variables. Usually, the investigator seeks to ascertain the causal effect of one variable upon another - in this case, the researcher want to understand the effects of accessibility micro finance institutions, interest rates, and availability of credit on the financial performance of a small/medium business.

The equation below explains the above relationship;

$\mathbf{Y} = \boldsymbol{\beta}_0 + \boldsymbol{\beta}_1 X_1 + \boldsymbol{\beta}_2 X_2 + \boldsymbol{\varepsilon}$

Y= Financial performance of Micro and Small Enterprises (MSE's) – (Dependent Variable)

$X_{1,}$ X_2 – Independent Variable

β_0= is the Constant term

$\beta_{1,}$ $\beta_{2,}$ = is the regression co-efficient associated with $X_{1,}$ X_2 respectively

X_1= Increase in Sales Volume of Micro and Small Enterprises (MSE's)

X_2= Loan Repayment capacity by the Micro and Small Enterprises (MSE's)

ε = error term.

From the regression analysis of this data, the following table 4.10 shows the model summary:

Table: 4.5: Coefficients

	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	2.763	0.08		-0.03	0.008
Loan Repayment capacity	0.563	0.001	0.561	2.414	0.011
Increase in Sales Volume	0.43	0.631	0.427	1.09	0.068
a. Dependent Variable: Financial Performance of Business due Loans					

The model from the above table will be:

$Y = 2.763 + 0.43 X_1 + 0.563X_2$

The regression analysis depicts that financial performance of MSEs would stand at 2.763 holding Loan Repayment Capacity and Increase in Sales Volume constant. The survey establishes that Loan Repayment Capacity is positively related to financial performance of MSEs. It also establishes that Increase in Sales Volume is positively related to financial performance of MSEs in Ndia Constituency.

4.5.1 Loan Repayment Capacity

The coefficient of Repayment Capacity is 0.563 (±0.011) this means that as repayment of loans becomes more difficult, the financial performance of MSEs is affected negatively. This also mean as the accessibility of Loans increase by unit of one it will lead to financial performance of MSEs by factors of 0.563.

The P-value of this figure is 0.011 (which is < 0.05 level of significance at 95% Confidence level) it means that the sample used was showed that Repayment of Loan is statistically significant.

4.5.2 Increase in Sales Volume

The coefficient of this variable is 0.43 (±0.068) this is an indication that as Sales increases, the financial performance of business would increase as the company is selling more outputs by factor of 0.43.

The P-value is 0.068, (which is > 0.05, it means that this Increase in sales volume is statistically significant at 95% Confidence level).

4.5.3 The model fit

Table 4.16: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.609[a]	0.37	. 728	. 236
a. Predictors: (Constant), Loan Repayment Capacity, Increase in Sales Volume and Increase in number of employees' constant				

The table above shows that the adjusted R Squared is 0.728 (72.8%) this means this model (Loan Repayment Capacity and Increase in Sales Volume and constant) explain only 72.8% of the financial performance of a business performance.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

In this chapter section 5.2 presents a summary of the findings, section 5.3 on the conclusion, section 5.4 discusses on the limitations of the study and section 5.5 gives recommendations for further research.

5.2 Summary of Findings

The study established that most Micro finance institutions take the age of a business into consideration before granting Loans. Most of the businesses were more than a year in operation before the Loan was granted. It is therefore evident that most of the financial institutions will not give a loan to a business when it is starting.

The study revealed that the process of accessing loans was difficult to a simple majority of 52.5% of the businesses that had accessed credit before. The loan processing entailed costs being incurred before he loans were granted such as cost of collecting collaterals, loan processing fee, inspection fee.

Some of the businesses interviewed had instances of denied accessibility or declined loans. Only 2 of the 40 businesses interviewed had been denied loan facility totally. The study revealed that the following were part of the reasons for the decline: Lack of collateral/security and High interest rate among others.

The study also established that most of the businesses obtained loans from Micro finance institutions. Half of the sample had accessed Loans from a Micro finance institution (50%). Second is Banks where 30% of the respondents reported to have got loans from.

ROSCAs, SACCO, RLF and friends and relatives also play a significant role in the provision of these services.

From the findings, after applying for credit, it is the wish of the applicant that they get the money as soon as possible so as to utilize it. This survey established that 72.5% of the loans take a week or more to be granted. Over 40% of the respondents felt that loans took longer periods than expected to be granted. This causes delay in business activities causing lost business and therefore low profitability.

The study revealed that interests could be expensive but manageable. The respondents were asked to share their expectations; if they were very dissatisfied, dissatisfied, satisfied and very satisfied with the rate of interest charged by micro finance institutions. Only 57.5% said that they were very dissatisfied and dissatisfied with interest charged by micro finance institutions.

The survey establishes that Increase in Sales Volume and Loan Repayment capacity is positively related to financial performance of MSEs in Ndia division. This is explained below. The established regression equation was:

$Y = 2.763 + 0.43 X_1 + 0.563X_2$

This explains that; a unit change increase in the ease of repayment of loans would cause increase of financial performance of a Micro and small enterprise by a factor of 0.563, a unit change increase in the sales volume would cause increase of financial performance of a micro and small enterprise by a factor of 0.43. From the model fit, the above 2 variables explain only 72.8% of the financial performance of a business, hence significant.

5.3 Conclusion

The study concludes that sales volume affects financial performance of MSEs positively, the higher the sales volume, the higher the financial performance of the MSEs. However, loan repayment capacity is not significant to entire objective of business financial performance.

The study also concludes that availability of credit positively affects financial performance of micro and small businesses. Most respondents said that once loans were applied for, it took the expected time (about a week). This is an indication that as credit becomes more available, the financial performance of business becomes better.

The study further concludes that the interest paid on loans were affordable. The interest rates would however affect financial performance of the businesses negatively. As the interest rate increases, the loans become more expensive and eat into the business profits.

The three variables under the study were not significant to the financial performance of the MSEs. This is because they explained only 72.8% of MSEs' financial performance. The research further that there are more other variables that could affect the financial performance of the businesses.

5.4 Recommendations

The study recommends that the government and financial institutions should make loans more accessible and available to enhance growth and development of MSEs through increased profitability. After it was found out that increased sales which comes as a result of a company accessing loans and being able to buy more outputs and loan repayment capacity have positive impacts on the performance of SMEs.

The study also recommends that the financial policy makers and interest rate regulators should work hand in hand to enhance reduction of interest rates so as to uplift the financial performance of MSEs accessing Loans.

The researcher suggests that further studies should be done to establish other factors that account for the 27.2% change in financial performance of MSEs.

5.5 Limitations

Micro and small enterprises owners do not maintain proper books of accounts it was therefore difficult accessing secondary data so as to check on their financial performance, as the information is not in the public domain and is considered confidential.

Therefore the outcome could have been different if financial performance information were used. The study only captured 40 MSEs, there are many MSEs that have not been included in the study. Also some of the respondents were very reluctant to fill the questionnaire and a lot of persuasion was needed, some respondent took long time to respond due to their busy work schedule.

Finally the research had to take longer time than anticipated since some respondents were not understanding what was required and its significance.

5.6 Suggestions for further Research

This study has concentrated on how micro finance institutions Loans accentuate the financial performance of micro and small enterprises in Ndia division. Therefore, it is interesting to understand if there could be a pattern to when micro finance Loans are used to evaluate the financial performance of micro and small enterprises, and in that case, how?

How micro finance loans are used in only some situations is touched upon, but not explored, in this study. Even though no conclusions can be drawn, this study further suggests that if the owners of micro and small enterprises already possess a certain level of knowledge there might not be a need for accentuating strategic aspects with the use of micro finance Loans.

It would therefore be interesting to further study why micro finance institutions are used to evaluate strategic aspects and especially study the relationship between knowledge and the use of micro finance loans to evaluate strategic aspects of the micro and small enterprises.

This could be pursued through the study of whether the applicability of micro finance Loans differs between different micro and small enterprises, and is therefore suggested as a topic for future research.

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APPENDIX

QUESTIONNAIRE TO CLIENT OF MFIs

A STUDY ON THE IMPACT OF MICRO FINANCE INSTITUTIONS ON THE FINANCIAL PERFORMANCE OF MICRO AND SMALL ENTERPRISES: A CASE STUDY IN NDIA DIVISION OF KIRINYAGA DISTRICT

MATHENGE GEORGE MWANGI

UNIVERSITY OF NAIROBI

I am pursuing master's degree program at the University of Nairobi and this research is a requirement towards fulfillment of the course. To facilitate the completion of my study I have designed the following questionnaire for the study on the impact of micro finance institutions on the financial performance of micro and small enterprises: a case study in Ndia division of Kirinyaga district. This study is an integral part of my study. A copy of the finds will be sent to you on request.

I would highly appreciate if you fill this attached questionnaire. It will take a few minutes of your time. It has questions about the impact of micro finance institutions on the financial performance of micro and small enterprises. Based on your experience and knowledge, please indicate the most appropriate response. The responses you provide in this questionnaire are completely confidential.

Section A: General Information

A1. Name of the business (Optional) …..……………………………………………..

A2. Location: …………………………………………………………………………

A3. Business Type ……………………………………………………………………….

Section B: Business information

B1. What was the source of your initial capital?

Personal Savings [ ] Friends and Relatives [ ] Loan from MFIs [ ] Others [ ]

B2. Did you have any business experience before starting this business?

Yes [ ] No [ ]

B3. Have you ever applied for a loan from any micro finance Institution?

Yes [ ] No [ ]

B4. If yes did you get the loan which you applied for?

Yes [ ] No [ ]

B5. If no, why was the loan not given?

Age of the borrower [ ]

Lack of sufficient collateral/security [ ]

Lack of guarantor [ ]

A risky business [ ]

Location of the business [ ]

High interest rate [ ]

Other reasons (Specify) ………………………………………………………….

B6. What amount of Loan have you received to your business from any MFIs in Ndia Division (in Kenya Shillings)?

Less than 10 Thousands [ ] (10 – 100) Thousands [ ] More than 100 Thousands [ ]

B7. How long have you been in this business?

Less than 1 year [ ]

1 – 2 Years [ ]

3 - 5 Years [ ]

6 – 10 Years [ ]

Over 10 Years [ ]

B8. Where do you borrow money for business most often?

	B1 (Single Answer)	B2 (Multiple answers)
Friends and Relatives	[ ]	[ ]
Rotating Savings and Credit Association (ROSCAs) (Chama)	[ ]	[ ]
Savings and Credit Cooperatives (SACCOs)	[ ]	[ ]
Accumulating Savings and Credit Association (ASCAs)	[ ]	[ ]
Money Lenders	[ ]	[ ]
Revolving Loan Fund (RLF)	[ ]	[ ]
Micro credit Finance	[ ]	[ ]
Banks	[ ]	[ ]

Others (Specify) ……………………………………………………………………

B9. How long does it take for you to get the Loan after the time of your application?

Less than 1 day [ ]

1 – 2 days [ ]

3 - 5 days [ ]

One week [ ]

One – Two weeks [ ]

More than Two weeks [ ]

B10. What is your opinion on the period taken to process the loan?

Shorter than expected [ ]
Very long [ ]
The expected time [ ]
Longer than expected [ ]

B11. The following indicate the degree of satisfaction of a person after receiving loan from MFIs

Using a rating scale of 1 to 5 { Very satisfied[5], Satisfied [4], No opinion[3], Dissatisfied [2], Very dissatisfied [1] }, please indicate your opinion on the following questions.

a. Is rate of interest rate of MFIs is reasonable?	[5]	[4]	[3]	[2]	[1]
b. Are the procedures of obtaining the loan from MFIs is easier than from banks?	[5]	[4]	[3]	[2]	[1]
c. Has the income generated by the business increased since you joined the MFI?	[5]	[4]	[3]	[2]	[1]
d. Has your savings increased since you joined the MFI?	[5]	[4]	[3]	[2]	[1]
e. Has the MFI helped you to access business education?	[5]	[4]	[3]	[2]	[1]
f. Has the MFI helped you to better financial situation of your family?	[5]	[4]	[3]	[2]	[1]
g. Has the MFI empowered you in decision making process?	[5]	[4]	[3]	[2]	[1]
h. Has the operational assistance received from MFIs been helpful in running your business?	[5]	[4]	[3]	[2]	[1]

B12. How many more Employees have you employed due to growth of your business?

1 [ ]　　2 [ ]　　3 [ ]　　4 [ ]　　5 and Above [ ]

Section C: Impacts of the Loan on the Business.

C.1 How many business loans you have taken in the past?

1 [ ] 2 [ ] 3 [ ] Others (more than 3) [ ]

C2: What is your Ability to repay your loan obligations? Explain how: ……………….

…………………………………………………………………………………………

……………………………………………………………………………………....

C3: What are the impacts of the Loans on the following social-economic issues?

C3.1: Have the Loans improved your business? Explain how: …………………….

…………………………………………………………………………………………

………………………………………………………………………………………….

C3.2: Have the Loans created more employment opportunities? Explain how: ....

…………………………………………………………………………………………

…………………………………………………………………………………………

C3.3: Have the Loans stimulated household savings? Explain how: ……………….

…………………………………………………………………………………………

…………………………………………………………………………………………

C4: Comment on the Performance of your Busisness,

C4.1: How is the General Performance ……………………………………………...

…………………………………………………………………………………………

…………………………………………………………………………………………

C4.2: Did you achieve you target of taking the loan: ……………………………….

…………………………………………………………………………………………

…………………………………………………………………………………………

C4.3: How is development and transformation in the future of your business……….……..……………………………………………………………

…………………………………………………………………………………………

………………………………………………………………………………………

C4.4: How have Sales Volume increased due to availability of cash flows………...

…………………………………………………………………………………………

………………………………………………………………………………………

C5. Did the time it took before receiving the loan you applied for, affect the financial performance of your business?

Yes [ ] No [ ]

C6. If yes how…………………………………………………………………………...

…………………………………………………………………………………………

……...

C7. Do MFIs have any Pre-Loan training for their clients?

Yes [ ] No [ ]

C8. From your own experiences how has the training helped clients of MFIs make informed decisions about their investments? ……………..

…………………………………………………………………………………………

……………………………………………………………………………………....

C9. Have you ever detected any general problems when working with MFIs?

List the problems…………………………………………………………………………..

…………………………………………………………………………………………

…………………………………………………………………………………….......

THANK YOU FOR YOUR COOPERATION