THE EFFECT OF MICROFINANCE INSTITUTION LENDING ON THE GROWTH OF SMALL AND MEDIUM ENTERPRISE IN SOMALIA

By

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NOVEMBER, 2013
DECLARATION

This research project is my original work and has not been presented for a degree in any other University.

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This research project has been submitted for the examination with my approval as the University Supervisor.

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DEDICATION

This project is dedicated to my family, specially my lovely mother Nura, my son Muscab and his mother who care of him, my wife Nasra, and all my brothers and sisters.
ACKNOWLEDGMENTS

First, I am indebted to the all-powerful GOD for all the blessings he showered on me and for being with me throughout the study. I am deeply obliged to my Supervisor, Mr. Herick Ondigo for his exemplary guidance and support without whose help; this project would not have been a success.

I take this opportunity to express my deep gratitude to the lasting memory of my loving family, and friends who are a constant source of motivation and for their never ending support and encouragement during this project.

Finally, it has been an exciting and instructive study period in the University of Nairobi and I feelprivileged to have had the opportunity to carry out this study as a demonstration of knowledge gained during the period studying for my master’s degree.

With these acknowledgments, it would be impossible not to remember those who in one way or another, directly or indirectly, have played a role in the realization of this research project. Let me, therefore, thank them all equally.
ABSTRACT

Microfinance provides a wide range of financial services to low-income clients, including self-employed and low earning individuals who are working in informal sectors. The study objective is to establish the effect of microfinance institutions lending on the growth of Small and Medium Enterprise in Somalia. The descriptive design was selected in this study because it would allow the researcher to gather numerical and descriptive data to assess the relationship between the variables. The study used probability sampling techniques to create a sampling frame for Small and medium enterprises. Stratified random sampling technique was used to select a total of 60 SMEs that constituted our sample size from infinite population of small and medium sized enterprise. Data collected from the questionnaire was analyzed, summarized, and interpreted accordingly with the aid of descriptive statistical techniques such as total score and simple percentages. In the process of data analysis the researcher used SPSS computer package to analyze the data.

It was found out that MFIs lending effect to the growth of small and medium enterprise in Somalia and have positive relationship. The study findings show that only a small percentage of the SMEs in Somalia are beneficiaries of the MFI lending services and has an effect on their growth. It was also accomplished that most of the requirements as collateral for loan application cannot be afforded by most SMEs, hence opting for cheaper sources of capital hence the low adoption of the loan services by MFIs. Other challenges causing low acceptance of the loans include: the long time taken processing loans, stringent repayment terms and the high transaction costs. MFI loans can be said to lead to the improvement in productivity among the beneficiary SMEs, as well as
profitability and the high number of entrepreneurs starting up new ventures. There exists a positive relationship between ROA and accessibility of credit in MFI, a negative one between ROA and the collateral of MFI lending and a positive one between ROA and group lending and individual lending.

The study recommends that there is a need for the government and other partners to facilitate the accessibility of credit in Small and Medium Enterprises to the Microfinance Institutions and minimize the collateral conditions. SMEs should be encouraged also to adopt group financing so as to avert loan defaulting. In order to reduce the rate of default, MFIs can research into very profitable business lines and offer credit to clients who have the capacity to exploit such business lines.
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<table>
<thead>
<tr>
<th>GB</th>
<th>Grameen Bank</th>
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<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
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<td>MFI</td>
<td>Microfinance Institutions</td>
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<tr>
<td>NGO</td>
<td>Non Governmental Organizations</td>
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<td>SME</td>
<td>Small and Medium Enterprise</td>
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<td>SSB</td>
<td>Salam Somali Bank</td>
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CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Microfinance, according to Otero (1999, p.8) is “the provision of financial services to low-income poor and very poor self-employed people”. These financial services according to Ledgerwood (1999) generally include savings and credit but can also include other financial services such as insurance and payment services. Schreiner and Colombet (2001, p.339) define microfinance as “the attempt to improve access to small deposits and small loans for poor households neglected by banks.” Therefore, microfinance involves the provision of financial services such as savings, loans and insurance to poor people living in both urban and rural settings who are unable to obtain such services from the formal financial sector.

The beginnings of the microfinance movement are most closely associated with the economist Muhammed Yunus, who in the early 1970's was a professor in Bangladesh. In the midst of a country-wide famine, he began making small loans to poor families in neighboring villages in an effort to break their cycle of poverty. Financial services that allow poor people to save in times of prosperity and borrow or collect insurance when necessary allow them to maintain a consistent level of consumption without selling off income-producing assets. Microfinance can also provide an opportunity for expanding or pursuing new business opportunities that allow poor people to increase or diversify the sources of their income.
The terms microcredit and microfinance are often used interchangeably, but it is important to highlight the difference between them because both terms are often confused. Sinha (1998, p.2) states “microcredit refers to small loans, whereas microfinance is appropriate where NGOs and MFIs1 supplement the loans with other financial services (savings, insurance, etc)”. Therefore microcredit is a component of microfinance in that it involves providing credit to the poor, but microfinance also involves additional non-credit financial services such as savings, insurance, pensions and payment services (Okiocredit, 2005).

Microcredit and microfinance are relatively new terms in the field of development, first coming to prominence in the 1970s, according to Robinson (2001) and Otero (1999). Prior to then, from the 1950s through to the 1970s, the provision of financial services by donors or governments was mainly in the form of subsidized rural credit programmes. These often resulted in high loan defaults, high lose and an inability to reach poor rural households (Robinson, 2001).

Robinson states that the 1980s represented a turning point in the history of microfinance in that MFIs such as Grameen Bank and BRI2 began to show that they could provide small loans and savings services profitably on a large scale. They received no continuing subsidies, were commercially funded and fully sustainable, and could attain wide outreach to clients (Robinson, 2001). It was also at this time that the term “microcredit” came to prominence in development (MIX, 2005). The difference between microcredit and the subsidized rural credit programmes of the 1950s and 1960s was that microcredit
insisted on repayment, on charging interest rates that covered the cost of credit delivery and by focusing on clients who were dependent on the informal sector for credit (ibid.). It was now clear for the first time that microcredit could provide large-scale outreach profitably.

The 1990s “saw accelerated growth in the number of microfinance institutions created and an increased emphasis on reaching scale” (Robinson, 2001, p.54). Dichter (1999, p.12) refers to the 1990s as “the microfinance decade”. Microfinance had now turned into an industry according to Robinson (2001). Along with the growth in microcredit institutions, attention changed from just the provision of credit to the poor (microcredit), to the provision of other financial services such as savings and pensions (microfinance) when it became clear that the poor had a demand for these other services (MIX, 2005).

As highlighted, one of the key roles microfinance has to play in development is in bringing access to financial services to the poor, to those who are neglected by the formal banking sector. This is their social mission. Mainstream banks target clients that have collateral. The poor do not have assets to act as collateral, therefore they are ignored by the formal financial sector. These banks tend to be found in urban centers while the majority of the poor in the developing world live in rural areas, where financial services are not provided. Therefore, if MFIs are to fill this void they must reach the rural poor. However, according to most studies, microfinance is only reaching a small fraction of the estimated demand of the poor for financial services (Littlefield and Rosenberg, 2004).
1.1.1 Microfinance Institutions Lending

Microfinance provides a wide range of financial services to low-income clients, including self-employed and low earning individuals who are working in informal sectors. The core objective of microfinance is to create a favorable environment for the low income self-employed and near-poor households in which they have permanent access to an appropriate range of high quality financial services, including not just credit but also savings, insurance, and general banking services. Microfinance provides a comprehensive range of financial services to the "unbanked people" working in informal sectors which best fits their needs and affordability.

The MFI subsequently provides different services to a client, most commonly in the form of a loan. These services lead to the client modifying her/his microenterprise activities which in turn lead to increased or decreased microenterprise income. The change in microenterprise income causes changes in household income which in turn leads to greater or lesser household economic security. The modified level of household economic security leads to changes in the morbidity and mortality of household members, in educational and skill levels and in future economic and social opportunities. Loans are delivered following the minimalist approach where the requirements for loans are not often difficult to meet by customers; little collateral, character and co-signing for loans between members. These loans are usually loans within the savings of the member (Schmidt, 1997).

**Group Lending** is independent variable in the model. This method of providing small credits to the poor is most use by microfinance that provides loans without collateral. The
interest charge is around not much different from that of commercial banks but far lower than interest charge by individual by money lenders (Natarajan, 2004). **Individual Lending** is independent variable in the model. This is the lending of loans to individuals with collateral. Besley and Coate (1995), say despite the advantages of lending to groups, some members of the group may fail to repay their loan. Montgomery (1996) stresses that this method of lending avoids the social costs of repayment pressure that is exerted to some group members. **Collateral** is an additional form of security which can be used to assure a lender that you have a second source of loan repayment. Assets such as equipment, buildings, accounts receivable, and (in some cases) inventory are considered possible sources of repayment if they can be sold by the bank for cash.

### 1.1.2 Growth of SME

Small and medium-sized enterprises (SMEs) play an important role in the world economy and contribute substantially to income, output and employment. However, the recent global financial crisis created a particularly tough climate for SMEs, with a reduction in demand for goods and services and a contraction in lending by banks and other financial institutions. They make a huge contribution to gross domestic product (GDP) and employment. The global financial crisis of 2008, however, created new challenges for SMEs. SMEs, by number, dominate the world business stage. Although precise, up-to-date data are difficult to obtain, estimates suggest that more than 95% of enterprises across the world are SMEs, accounting for approximately 60% of private sector employment (Ayyagari et al. 2011). Japan has the highest proportion of SMEs among the industrialized countries, accounting for more than 99% of total enterprises. India,
according to its Ministry of Micro, Small and Medium Enterprises, had 13 million SMEs in 2008, equivalent to 80% of all the country’s businesses. In South Africa, it is estimated that 91% of the formal business entities are SMEs (Quartey 2010).

The contribution made by SMEs does vary widely between countries and regions. Nevertheless, although they play particularly key roles in high-income countries, SMEs are also important to low-income countries, making significant contributions to both GDP and employment. They are also major contributors to innovation in economies, partly through collaboration with the larger corporate sector. As noted, SMEs tend to be more labour intensive and at a macro level, therefore, provide a substantial contribution to employment. A World Bank survey of 47,745 businesses across 99 countries revealed that firms with between 5 and 250 employees accounted for 67% of the total permanent, full-time employment (Ayyagari et al. 2011). SMEs were also creating more jobs than large enterprises. Between 2002 and 2010, on average, 85% of total employment growth was attributable to SMEs.

**Profitability** is a measure of dependent variable (Growth of SMEs). Profitability is one of the important measures of growth that must be considered as it is unlikely that firm growth can be sustained without profits being available for reinvestment in the firm. Growth along this dimension can be considered in terms of net profit margins or return on assets. If we take the definition of enterprise as the creation of rents through innovation (Stewart, 1991) where rents are defined as above average earnings relative to
competitors, then profitability measures are particularly attractive. This also implies that economic success is required by high performance firms.

1.1.3 The Effect of MFI Lending on Growth of SMEs

Lack of access to finance has been identified as one of the major constraints to small business growth (Owualah, 1999; Carpenter, 2001; Anyawu, 2003; Lawson, 2007). The reason is that provision of financial services is an important means for mobilizing resources for more productive use. The extent to which small enterprises could access fund is the extents to which small firms can save and accumulate own capital for further investment (Hossain, 1988). However, small business enterprises find it difficult to access formal financial institutions such as commercial banks for funds. The inability of the SMEs to meet the standard of the formal financial institutions for loan consideration provides a platform for informal institutions to attempt to fill the gap usually based on informal social networks, and this is what gave birth to micro-financing.

Zeller (2001) argue that insufficient access to credit by the poor just below or just above the poverty line may have negative consequences for SMEs and overall welfare. Access to credit further increases SME’s risk-bearing abilities; improve risk-copying strategies and enables consumption smoothing overtime. With these arguments, microfinance is assumed to improve the welfare of the poor.

1.1.4 SMEs in Somalia

Somalia is a long, narrow country on Africa’s eastern coast that has a population of about 10 million (WHO, n.d.). By the 12th century, clan families were established and the
widespread conversion to Islam had begun (Putnam & Noor, 1999). Although the government of Somalia’s initially socialist republic had a better relationship with the Soviet Union than with the United States, the government still encouraged democratic participation. However, by the late 1960s, the government was widely considered corrupt and inefficient. Shortly after the assassination of Somalia’s president in 1969, a coup led by General Mohammed Siad Barre overthrew the civilian government. Barre then ruled Somalia for the next 22 years. Initially, Barre’s rule was popular, but nepotism and lack of accountability lead to widespread inequality, which was incompatible with Somali egalitarianism. Under Barre’s oppressive, autocratic rule, clan-based opposition militias formed and were manipulated by Barre’s regime. In 1990, a full-scale civil war broke out and ultimately led to Barre’s overthrow and exile in 1991, and to the disintegration of the central government (Putnam & Noor, 1999). The civil war and ongoing clan violence have handicapped the country’s infrastructure and economy.

A small scale enterprise is a privately owned and operated business, characterized by a small number of employees and low turnover. A small enterprise usually only shares a tiny segment of the market it operates in. Small scale enterprises (also, small scale businesses) are essential to the economy for industrial growth and diversification. The definition of a small scale enterprise may vary in different economies of the world, but the underlying concept is the same. Some measures used to define small scale enterprises include annual sales, asset valuation, net profit, headcount and balance sheet totals. Perhaps the most important measure in defining small scale enterprises is the number of
people employed by the business. In African nations, a business is considered to be small scale if it employs less than 30 people.

In Asian countries, it is between 30 and 100, while in the United States it is any number below 500. A medium scale enterprise is a privately owned and operated business characterized by a medium number of employees and low turnover. In Somalia there is no proper agreement the definition medium scale enterprises however in African nation a business is considered to be medium scale enterprise if it employs 30 to 50. (Edgcomb & Klein, 2005). The Small and Medium Enterprises (SME) in Somalia constitute the large part of the private sector with specific reference to their numbers and employment figures. Most of these enterprises are indigenously owned and family run, less than five years old and rarely grow beyond medium scale level due to lack of access to markets and finance, limited skills and enterprise -to-enterprise linkages that would provide opportunities for growth. The accessibility of microfinance services could be considered difficulty to small businesses due to the heavy collateral requirement that MFIs may impose.

1.2 Research Problem

Microfinance is the provision that provides access to various financial services such as credit, savings, micro insurance, remittances, leasing to low-income clients including consumers and the self employed, who traditionally lack access to banking and related services. Its main objective is to provide a permanent access to appropriate financial services including insurance, savings, and fund transfer. It is rather an important tool for
the eradication of poverty. As microfinance becomes more widely accepted and moves into main stream, the supply of services to poor may also increase, improving the efficiency and outreach while lowering the costs. A study of MFIs in seven countries carried out by Mosley and Hulme (1998) concludes that household income tends to increase at a decreasing rate as the income and asset position of the debtors is improved. Diagne and Zeller (2001) in their study in Malawi suggest that microfinance do not have any significant effect in household income meaning no effect on SME development. Investing in SME activities will have no effect in raising household income because the infrastructure and market is not developed.

Yasin, (2013), adapted a study of Microfinance lending relevance to the SMEs growth in Mogadishu, Somalia. The study identifies that Small businesses in Mogadishu are facing challenges to access loan from MFIs and this results many small business to demise soon or may not be started due to lack of ability to overcome the challenges. The finding showed how SMEs in Mogadishu face some requirements to have an access to borrow money from Microfinance institutions. Also the findings revealed that the requirements hinder the possibility of borrowing money from microfinance institutions so as to start, run or expand small businesses. It is because of the fact that the SMEs owners cannot meet the requirements set by the Microfinance institutions.

Buckley (1997) did a study on the effect of MFI lending to the growth of SMEs and found that, the indicators of success of microcredit programs namely high repayment rate, outreach and financial sustainability does not take into consideration what impact it has on micro enterprise operations and only focusing on “microfinance evangelism”.
Carrying out research in three countries; Kenya, Malawi and Ghana, Buckley (1997) came to the conclusion that there was little evidence to suggest that any significant and sustained impact of microfinance services on clients in terms of SME development, increased income flows or level of employment.

Markowski (2002) conducted a study on the contribution of MFIs to the enterprise, in their project designs are failing to meet the needs of the very poor and destitute, who do have a demand for microfinance services, especially for savings (Littlefield and Rosenberg, 2004 and Dichter, 1999). They are ignored, yet an objective of the Microcredit Summit is to reach 175 million poor people by 2015 but MFIs do not seem to be on target for meeting this objective. Therefore, the effect of microfinance on small and medium business has not received adequate research attention in Somalia. This means that there is a major gap in the relevant literature on developing countries including Somalia, which has to be covered by the research. This research attempts to fill this gap by studying the situation in Mogadishu, Somalia and providing more empirical evidence on the effects of microfinance on developing Business. This study intent to address the following research question, what is the effect of microfinance institutions lending on the growth of small and medium enterprise in Somalia?.

1.3 Research Objective

To establish the effect of microfinance institutions to the growth of Small and Medium Enterprise in Somalia.
1.4 Value of the Study

This study may provide a better understanding to microfinance programs and how microfinance institutions can contribute to the growth of small and medium enterprise. Microfinance institutions and governments may benefit from the findings of this study and may help to understand how to improve the microfinance.

This study will generate useful insights that can be used by the government and Non-governmental organization to promote the accessibility of credit to the small and medium enterprise from microfinance institutions and to ensure that policies are institute to facilitate easy access of loans by SMEs from MFIs.

The findings may also contribute to the existing knowledge of microfinance related to the effect on growth of SMEs and would be value to the future research. Academicians will enrich the literature available on microfinance and their effect on growth of SMEs
CHAPTER TWO
LITERATURE REVIEW

2.1 Introduction

This chapter focuses on the concepts of microfinance and the role they play in the growth of SMEs. It highlights Concepts, Ideas, theories, and Opinions from Authors/ Experts, theoretical perspectives. Also it describes related studies. It involves secondary data obtained from textbooks, journals and internet.

2.2 Theoretical Review

This section highlights theoretical reviews of microfinance lending on growth of SMEs and this study will be grounded on the transaction cost theory, theories of stage of development and passive learning model theory.

2.2.1 Transaction Cost Theory

Transaction cost approach to the theory of the firm was created by Ronald (1937) in his article "The Problem of Social Cost" “In order to carry out a market transaction it is necessary to discover who it is that one wishes to deal with, to conduct negotiations leading up to a bargain, to draw up the contract, to undertake the inspection needed to make sure that the terms of the contract are being observed, and so on”. More succinctly transaction costs are: Search and information costs, bargaining and decision costs, and policing and enforcement costs. The transaction cost can be conceptualized as a nonfinancial cost incurred in credit delivery by the borrower and the lender before, during and after the disbursement of loan. The cost incurred by the lender include; cost of
searching for funds to loan, cost of designing credit contracts, cost of screening borrowers, assessing project feasibility, cost of scrutinizing loan application, cost of providing credit training to staff and borrowers, and the cost of monitoring and putting into effect loan contracts. On the other hand, the borrowers that is SMEs for this case may incur cost ranging from cost associated in screening group member (group borrowing), cost of forming a group, cost of negotiating with the lender, cost of filling paperwork, transportation to and from the financial institution, cost of time spent on project appraisal and cost of attending meetings. The parties involved in a project will determine the transaction cost rate. They have the sole responsibility to reduce the risk they may come across, Stiglitz (1990).

2.2.2 Theories of Stage of Development

According to the influential theory of Churchill and Lewis (1983), growth is part of the natural evolution of a firm. The authors identify five stages of growth: existence, survival, success, take-off and resource maturity. In each stage of development a different set of factors is critical to the firm's survival and success. Growth thresholds may exist as obstacles to the transition from one stage to another. Accordingly, in the take-off stage – most relevant in a study of rapid growth – there are two major concerns or obstacles to firm growth: the ability of the owner to hire new people and delegate responsibility. The business will also need enough cash to satisfy the greater demand for financial resources brought about by growth.
2.2.3 Passive Learning Model

In the Passive Learning Model (PLM), Jovanic 1982 cited in Agaje (2004), a firm enters a market without knowing its own potential growth. Only after entry does the firm start to learn about the distribution of its own profitability based on information from realized profits. By continually updating such learning, the firm decides to expand, contract, or to exit. This learning model states that firms and managers of firms learn about their efficiency once they are established in the industry. Firms expand their activities when managers observe that their estimation of managerial efficiency has understated actual levels of efficiency. As firm ages, the owner’s estimation of efficiency becomes more accurate, decreasing the probability that the output will widely differ from one year to another. The implication of this theoretical model is that smaller and younger firms should have higher and more viable growth rates.

2.3 The Determinant of Growth for SMEs

Growth is sometimes regarded as the most important, reliable and easily accessible measure of a firm’s performance. Small and Medium Enterprises (SMEs) by virtue of their size, location, capital investment and their capacity to generate greater employment have proved their paramount effect on rapid economic growth. The rapid growth of global markets observed over the last decade has stimulated competition in both developed and developing countries, forcing entrepreneurs and policy makers to adopt market-oriented policies. The fact that the share of SMEs has increased in these countries suggests that efficient SMEs have actually been able to deploy new strategies in order to maintain, or even enhance, their competitiveness in a globalised economy. Many
different theories have attempted to identify the main factors underlying firm growth. They can be divided into two main schools: the first addresses the influence of firm size, profitability and age on growth, while the second deals with the influence of variables such as strategy, organization and the characteristics of the firm’s owners/managers.

Profits are necessary for survival in the long run in a competitive environment, but SME management may choose not to grow. Long-term profitability derives from the relations between cost and revenue; it is a necessary but not sufficient condition for growth. Revenues may be held up by entry barriers and costs pushed down by management ingenuity. A low-profit firm will lack the finance for expansion, but a high-profit business may conclude the risk and rewards of expansion are inadequate. In a ‘life style’ SME, an owner may trade profitability today against profitability tomorrow. Dynamic pricing or sequential investment projects may require initially lower profits in order to obtain higher future pay-offs from greater market penetration. An SME manager’s time preference is likely to determine the inter-temporal profit trade-off.

In fact, a huge number of studies have been devoted to examining the relationship between growth and the firm’s size and age. For example, Evans (1987) examined the effects of firm size and age on growth using data on business firms in the United States. Although several previous studies had supported Gibrat’s law that hypothesizes that growth is independent of size, Evans (1987) found that firm growth decreases with firm size and age. However, the empirical literature has suggested that firm growth is determined not only by the traditional characteristics of size and age but also by other firm-specific characteristics. For example, Heshmati (2001) found that the degree of
indebtedness positively affects sales growth using data on Swedish micro and small firms, while Becchetti (2002) documented the effect of external finance on firm growth in the Italian manufacturing industry, apart from the traditional determinants of age and size.

2.4 Empirical Review

Kushoka (2013) adapted a research to examine the contribution of microfinance institutions on enterprise development in Tanzania. The article is aimed at moving poor small-scale entrepreneurs and/or would-be entrepreneurs from low-growth enterprises to high-growth Enterprises using Microfinance Institutions (MFIs). The study employed both descriptive and explanatory approaches to seek answers to the research question. The study reveals that there is an increase in the number of employees and amount of working capital of entrepreneurs after using the services of Microfinance Institutions (MFIs). The researcher concludes that Microfinance Institutions (MFIs) are key players in entrepreneurship development; it is recommended that Microfinance Institutions (MFIs) should package their services together (financial and non-financial) in order to positively boost growth of Micro Small and Medium Enterprises (MSMEs).

Sakthi (2011) and Praveen Kumar S. conducted a research study about the role of microfinance institutions in the development of entrepreneurs in Africa. The study is focus for entrepreneurs who want to run a business and yet can't afford a piece of equipment and merchandise. The research whereby providing equipment or merchandise to enable the project to run a self funding profitable project. The research find out that only 6 % of Africans borrow money to start a business where as 13 % borrow to buy
food. 50% of the population live with less than 1US$ or less per day. Most of the Africans lack the understanding of what it would take to successful entrepreneurs. They lack necessary technical management skills and confidence. They lack personal ambition and willingness for fear of sharing ownership and failed to form partnership.

Ekpe (2010) have studied the effect of Microfinance factors on women Entrepreneurs’ performance in Nigeria. Women play a crucial role in the economic development of their families and communities but certain obstacles such as poverty, unemployment, low household income and societal discriminations mostly in developing countries have hindered their effective performance of that role. It is discovered that women entrepreneurship could be an effective strategy for poverty reduction in a country; since women are the worst hit in such situation. However, it is discovered that women entrepreneurs, especially in developing countries, do not have easy access to microfinance factors for their entrepreneurial activity and as such have low business performance than their men counterparts, whereas the rate of their participation in the informal sector of the economy is higher than males, and microfinance factors could have positive effect on enterprise performance.

Mamun (2009) did his studies of microfinance in Bangladesh for graduation Masters Degree Program from the University of Glamorgan, UK. The aim of the study was to assess the factors that led to the success of Microfinance, in particular, Grameen Bank (GB), in Bangladesh. The study was investigated the innovation, design and implementation of GB. Besides, this research also examined the adaptation and learning practice of GB and the motivation and contribution of GB and some environmental
factors that supported GB especially in Bangladesh. The study findings were in relation to the purpose of this research. This study revealed that some innovation, design and implementation of GB such as group based lending, the collateral free lending system, peer group monitoring system, the designed training staff of GB were the major factors that contributed to the success of micro-finance; the adaptation and learning practice such as flexibility of obtaining a loan, a housing loan with lower interest rate, mandatory and voluntary savings were the most significant issue; the motivation of GB such as incentive schemes to staff, encouragement for financial independent by the borrowers of GB, borrowers motivated to mobilize and allocate resources were also the most leading issue, the contribution of GB such as microfinance programme contributed to female’s control over resources and decision making at family level enormously as well as the environmental issues such as ongoing population growth that favoured GB very significantly. Finally, the researcher recommended that GB should necessitate the expansion of the organizational capability to recognize the appropriate innovation, creating the cultural innovation, sustainable development programme on the basis of demands and problems of the borrowers, the initiative for an appropriate macro-economic policy and financial designs in order to alleviate the poverty from the rural economy.

Olu (2003) investigates the impact of microfinance on entrepreneurial development of small scale enterprises that are craving for growth and development in a stiffened economy called Nigeria. The study reveals that (i) there is a significant difference in the number of entrepreneurs who used microfinance institutions and those who do not use them; (ii) there is a significant effect of microfinance institutions activities in predicting entrepreneurial productivity; and (iii) that there is no significant effect of microfinance
institutions activities in predicting entrepreneurial development. The researcher concludes that microfinance institutions world over and especially in Nigeria are identified to be one of the key players in the financial industry that have positively affected individuals, business organizations, other financial institutions, the government and the economy at large through the services they offer and the functions they perform in the economy.

In Somalia there is no enough academic studies towards on the effects of microfinance institutions on a growth Business. Yasin (2013) adapted a study of Microfinance relevence to the business in Magadishu, Somalia. The main objective of the study was to examine the challenges facing by small businesses in accessing microfinance services in Mogadishu. Purposive sampling technique was employed in selecting the 100 Small businesses that constituted the sample size of the research. The study identifies that Small businesses in Mogadishu are facing challenges to access loan from MFIs and this results many small business to demise soon or may not be started due to lack of ability to overcome the challenges. Therefore, since the researchers mentioned that there is a challenges facing small business in accessing microfinance, this research will cover the extent of how these challenge of credit from microfinance instititions effect the growth of smal and meduim entreprise in Somalia.

2.5 Summary of Literature Review
The current theories on microfinance postulate that microfinance structures are essential for development which is based on three basic assumptions: one is that poor populations
possess the capacity to implement income generating activities. Two is the idea that poor people given access to capital and guided properly are in a position to implement and manage income generating business enterprises. Three is that once the financial systems are established, the poor people "are able to use it (the financial tools) for productive purposes and progressively incorporate themselves into the financial milieu, repaying the loans, and accumulating savings”. This is because microfinance provides the means to generate income that eventually leads to a sustainable development. The informal sector became more important in the 1970s and 1980s as the reliance of household members on formal wage earnings was replaced by informal income generating activities (Tripp, 1996).

The rapid growth was initiated by the informal enterprises themselves as a measure of survival following the failure of the state (Maliyamkono & Bagachwa, 1990; Rutashobya & Olomi 1999). The decline of real wages, persistent inflation, and the decline of the formal sector employment attributed to the rapid expansion of the informal sector (Bagachwa 1995). In addition, commercial banks were encouraged to provide services to this sector through loan quotas, subsidies, tax breaks, training and guarantees against defaults. Despite massive subsidies, development banks created by Governments in developing countries have had little success in reaching the intended beneficiaries (UNCTAD 1995).

Finally, the effect of microfinance on small and medium business has not received adequate research attention in Somalia. This means that there is a major gap in the
relevant literature on developing countries including Somalia, which has to be covered by the research. This research attempts to fill this gap by studying the situation in Somalia and providing more empirical evidence on the effects of microfinance on the growth of enterprise.
CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter comprises the research design, population, sampling, data collection, data analysis and data validity and reliability.

3.2 Research Design

This section focuses on the research techniques adopted and used for this study with the aim of achieving the research objectives. A research design is defined as an overall plan for research undertaking. Research design provides the glue that holds the research project together. Descriptive research design was adopted in this study. Cooper (2003) observed that descriptive studies are structured with clearly stated questions to be investigated. The descriptive design was selected in this study because it would allow the researcher to gather numerical and descriptive data to assess the relationship between the variables.

3.3 Population of Study

The population refers to the entire group of people, events, or things of interest for which the researcher wishes to investigate. The research will conduct small and medium sized enterprises in Mogadishu and the population of the study is infinite since there is no registration and regulation controlling the number of SMEs in Mogadishu, Somalia. The area was selected because the microfinance institutions in Somalia are located mostly in Mogadishu and small and medium sized enterprises in this area use MFIs services.
3.4 Sample

The study used probability sampling techniques to create a sampling frame for Small and medium enterprises. Stratified random sampling technique was used to select a total of 60 SMEs that constituted our sample size from an infinite population of small and medium-sized enterprises. The reason of choosing Stratified random sampling technique was to obtain estimates of known precision for certain subdivisions of the population by treating each subdivision as a stratum. Since sampling was done independently in each stratum, separate stratum estimates and their precision can be obtained by treating each stratum as a sample in its own right. Once the population has been stratified in a meaningful way, a sample of members from each stratum can be drawn using a systematic sampling procedure. For example, it was categorized 30 stratum for medium enterprise and 30 for small business which gives the total sample of 60.

3.5 Data Collection

Every research work has a framework for collecting data. Its function is to ensure that the required data are collected accurately and economically. Primary method of data collection was used in this study and the tool used for data collection was questionnaire techniques method. The variables in the questionnaires were mainly developed based on the themes in the literature review section and research objectives. The primary data consists of a number of items in well-structured questionnaire that was administrated to and completed by the respondents. The decision to structure the questionnaire was predicated on the need to reduce variability in the meanings possessed by the questions as a way of ensuring comparability of responses.
3.5.1 Data Validity and Reliability

One important way of ensuring that we have used the right instrument and have taken correct measurement was that our outcome must be in consonance with two major criteria for measuring quality known as validity and reliability (Ojo, 2003).

To make sure the validity and reliability of the questionnaire used for the study, researcher used SPSS to look at the questionnaire items in relation to its ability to achieve the stated objectives of the research, level of coverage, comprehensibility, logicality and suitability for prospective respondents.

3.6 Data Analysis

Data collected from the questionnaire was analysed, summarized, and interpreted accordingly with the aid of descriptive statistical techniques such as total score and simple percentage. In the process of data analysis the researcher was used descriptive and statistical analysis with the help of the SPSS computer package to analyze the data. Regression model was used to analyze relationship between the effect of MFI lending and the growth of SMEs.

3.6.1 Analytical Model

The Regression equation represents the independent (MFIs) and dependent (SMEs) variables and expressed as follows:

\[ Y = \alpha + \beta_1 X + \beta_2 X + \varepsilon \]

Where:
Y = Growth of SMEs as measured by profitability

X1 = The Accessibility of credit in MFI

X2 = The collateral of MFI lending

X3 = Individual lending

X4 = Group lending

\( \beta = \) the coefficient of independent variables

\( \alpha = \) Intercept that is the value of Y when all other variables take the value of zero

\( \varepsilon = \) Error term

The independent variable X1, X2, X3 and X4 are the variables of MFI used for this study which was measured using the various questions asked the respondents in the questionnaire. The regression function shown above is to investigate the effect of growth on SMEs in relation to MFI lending. The change in value of \( \alpha \) would be the degree of effects on growth of SME and the positive and negative sign of the value showed how the direction of effects would be.

Test of significance was established and the coefficient of determination (\( R^2 \)) was used to found the predictive effect independent variable (the strength of the model) to the dependent variables. The model makes use of regression and analysis of variance (ANOVA) to reveal the relationship between independent variables and dependent variables.
CHAPTER FOUR
DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction
This chapter covers data presentation and analysis. The study objective was to establish the effect of microfinance institutions lending to the growth of Small and Medium Enterprise in Somalia. The reliability and viability of the data collected for the study was ascertained through using the SPSS to test the internal reliability of the measurement instrument.

4.2 Descriptive Statistics
4.2.1 Response Rate
The study targeted the small and medium sized enterprises in Mogadishu. Owing to the relatively of unregistered SMEs, the study adopted a Stratified random sampling technique to select a total of 60 SMEs that constituted the sample size from infinite population of small and medium sized enterprise. To this end, a total of 60 SMEs were expected to participate in the study. An 83.3% response rate was therefore attained, with only 50 SMEs managing to respond. According to Mugenda and Mugenda (1999), a response rate of 50% is adequate for analysis and reporting; a rate of 60% is good and a response rate of 70% and over is excellent. It therefore goes that the study registered an excellent response rate. This is reflected in the table below.
4.2.2 Demographic Information

This section captures the respondent’s demographic information as regards the number of SMEs and business type.

4.2.2.1 Respondents’ Age

The study sought to establish the respondents’ age brackets, to get an overview of the demographic characteristics in age categories of the population engaged in small and medium enterprise in the study area. Findings are presented in figure 4.1 below.

Figure 4.1 Respondents’ Age Categories

![Chart showing respondents' age categories]

Source: Research findings
From the figure, it is observed that most respondents fall within the 22-26 age bracket as indicated by 23 (46.0%) of the respondents. This, points to the assumption that the overall population engaging in the SMEs industry is youthful.

4.2.2.2 Respondents’ Gender

The study further sought to find out the gender distribution among the respondents. This would serve to establish the gender parity in the SME industry in the study area. Figure 4.2 below presents the findings.

**Figure 4.2 Respondents’ Gender**

![Figure 4.2 Respondents’ Gender](image)

*Source: Research findings*

From the figure, it is observed that the male respondents, 33 (66.0%), recorded the highest as compared to their female counterparts, 17 (34.0%). It can be concluded from the finding that the SME sector is male dominated in Somalia.
4.2.2.3 Type of Enterprise

The study sought to establish the type of business the various SMEs engage in. This serves to give the researcher an overview of the operations taking place in the SME sector in the study area, Somalia. Findings are as illustrated in table 4.2 and figure 4.3 below.

Table 4.2 Descriptive Statistics on the Type of Enterprise

<table>
<thead>
<tr>
<th>Statement</th>
<th>N</th>
<th>Mean</th>
<th>SD</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cloths</td>
<td>50</td>
<td>6.45</td>
<td>.421</td>
</tr>
<tr>
<td>Electronics/Accessories</td>
<td>50</td>
<td>5.01</td>
<td>.498</td>
</tr>
<tr>
<td>Bookshop</td>
<td>50</td>
<td>4.53</td>
<td>.544</td>
</tr>
<tr>
<td>Service</td>
<td>50</td>
<td>4.24</td>
<td>.547</td>
</tr>
<tr>
<td>Construction</td>
<td>50</td>
<td>4.24</td>
<td>.523</td>
</tr>
<tr>
<td>Cosmetics</td>
<td>50</td>
<td>4.12</td>
<td>.465</td>
</tr>
<tr>
<td>Shoes</td>
<td>50</td>
<td>2.43</td>
<td>.437</td>
</tr>
<tr>
<td>Others</td>
<td>50</td>
<td>2.38</td>
<td>.461</td>
</tr>
</tbody>
</table>

Source: Research findings

The means from the table above suggest that a majority of the SMEs engage in either cloths (X= 6.45, S.D = .421) or electronics/accessories (X = 5.01, S.D = .498). Shoes (X= 2.43, S.D = .437) and the ‘others’ (X = 2.38, S.D = .461) categories recorded the lowest means suggesting a low number of SMEs engaging in the sectors. Figure 4.2 below provides a clearer view of the findings in frequencies and percentages.
From the findings, it is observed that a majority of the SMEs in Somalia engages in cloths merchandise as indicated by a majority, 13 (26.0%), of the respondents. This is closely followed by those in Electronics/Accessories (11, 22.0%). Cosmetics (3, 6.0%), Shoes (2, 4.0%) and Others (2, 4.0%) recorded the lowest. This finding is reflective of the nature of business different SME establishments engage in.

4.2.3 Credit Accessibility of SMEs

This section presents the respondents’ perspectives in respect to credit accessibility for the SMEs.

4.2.3.1 Source(s) of Your Business Capital

The study sought to identify the various sources of capital for the respondent SMEs. This served as a build up to the establishment of credit accessibility to the SMEs. Table and figure 4.3 illustrate the findings.
Table 4.3 Descriptive Statistics on the Source(S) of Your Business Capital

<table>
<thead>
<tr>
<th>Statement</th>
<th>N</th>
<th>Mean</th>
<th>SD</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personal savings</td>
<td>50</td>
<td>2.83</td>
<td>.422</td>
</tr>
<tr>
<td>Family</td>
<td>50</td>
<td>4.51</td>
<td>.577</td>
</tr>
<tr>
<td>Micro finance institutions</td>
<td>50</td>
<td>4.92</td>
<td>.498</td>
</tr>
<tr>
<td>Partnership</td>
<td>50</td>
<td>6.04</td>
<td>.567</td>
</tr>
<tr>
<td>Others</td>
<td>50</td>
<td>2.15</td>
<td>.437</td>
</tr>
</tbody>
</table>

Source: Research findings

The means from table 4.3 above suggest that a majority of the SMEs source their capital from partnerships (X = 6.04, S.D = .567) followed by family sources (X = 4.51, S.D = .577). A relatively low number of SMEs get their capital from MFIs (X = 4.92, S.D = .498). Figure 4.3 below provides a clearer view of the findings in frequencies and percentages.

Figure 4.4 Respondents’ Source of Capital

Source: Research findings
From the figure, it is established that that most SMEs get their capital through partnerships as indicated by 18 (36.0%) of the respondents, the majority. Most also get their capital through family member contributions as indicated by 13 (26.0%) of the respondents. Only 9 (18.0%) of the respondents get their capital through Micro Finance Institutions while the rest acquire capital from personal savings and other means. This finding is of utmost relevance to the study as it aims to establish the effect of microfinance institutions to the growth of Small and Medium Enterprise in Somalia. It therefore goes that only 18% of the SMEs in Somalia are beneficiaries of the MFI loaning services.

4.2.3.2 Whether MFIs Required Collateral Before Giving Out Loans

Respondents acquiring capital from MFIs were further asked of whether the MFIs required collateral before giving out loans. This served to enable the researcher get an overview of some of the procedural challenges the SMEs went through in acquiring loans from the financial institutions. All the respondents affirmed to the question. This, points out one of the requirements for loaning SMEs applied by the MFIs.

4.2.3.3 Whether SMEs Could Afford Collaterals Requested

The study further hunted to find out whether the SMEs benefiting from the MFI loans could afford availing the collaterals as required by the lending institutions. It was established that an overwhelming 36 (72%) of the respondents could not afford the collaterals.
Figure 4.5 Whether SMEs Could Afford Collaterals Requested by MFIs

Source: Research findings

This is a possible explanation for the low numbers of SMEs sourcing their capital from the MFIs. It therefore goes that most of the requirements as collateral for loan application cannot be afforded by most SMEs, hence opting for cheaper sources of capital.

4.2.3.4 Challenges Faced by SMEs in Getting Loans from MFIs

The study further sought to establish whether the SMEs faced any challenges in the acquisition of loans from the MFIs and if so, what challenges they faced. 39 (78%) of the respondents confirmed that indeed they faced challenges in acquiring loans. Asked on what challenges they faced included: length of time taken in processing the loans ($X = 5.56, SD = .433$); raising collateral ($X = 6.12, SD = .431$); stringent repayment terms ($X = 5.96, SD = .574$) and high transaction costs ($X = 5.88, SD = .523$). The means and standard deviations of the responses are provided in table 4.4 below.
Table 4.4 Challenges Faced by SMEs in Getting Loans from MFIs

<table>
<thead>
<tr>
<th>Statement</th>
<th>N</th>
<th>Mean</th>
<th>SD</th>
</tr>
</thead>
<tbody>
<tr>
<td>Long time taken processing loans</td>
<td>50</td>
<td>5.56</td>
<td>.433</td>
</tr>
<tr>
<td>Difficulty raising collateral</td>
<td>50</td>
<td>6.12</td>
<td>.431</td>
</tr>
<tr>
<td>Stringent repayment terms</td>
<td>50</td>
<td>5.96</td>
<td>.574</td>
</tr>
<tr>
<td>High transaction costs</td>
<td>50</td>
<td>5.88</td>
<td>.523</td>
</tr>
</tbody>
</table>

Source: Research findings

The means from table 4.3 above indicate the major challenges a majority of SMEs face in accessing loans form MFIs. The high means recorded that most SMEs face the same challenges. It can thus be concluded that most SMEs shy away from utilizing the MFIs loans and opt for other sources, due to the long time taken processing loans, difficulty raising collateral, stringent repayment terms and the high transaction costs.

4.2.4 SMEs Growth and MFI Lending

On a five-point linker scale (1-Strongly disagree, 2-Disagree, 3- Natural, 4-Agree 5- Strongly agree) respondents were requested to indicate their responses to statements posited by the researcher in respect to SME growth and MFI lending. The means and standard deviations were generated as tabled in table 4.x below.
Table 4.5 Descriptive Statistics on SMEs Growth and MFI Lending

<table>
<thead>
<tr>
<th>Statement</th>
<th>N</th>
<th>Mean</th>
<th>SD</th>
</tr>
</thead>
<tbody>
<tr>
<td>Microfinance institutions funds increases the profitability of the small and medium enterprise</td>
<td>50</td>
<td>4.94</td>
<td>.398</td>
</tr>
<tr>
<td>MFI contributed increases the number of entrepreneurs who Starting new venture</td>
<td>50</td>
<td>4.33</td>
<td>.511</td>
</tr>
<tr>
<td>SMEs increase their productivity through getting fund MFIs which leads enterprise growth</td>
<td>50</td>
<td>4.12</td>
<td>.461</td>
</tr>
<tr>
<td>MFI provided individual lending to the entrepreneurs of small and medium enterprise</td>
<td>50</td>
<td>5.23</td>
<td>.419</td>
</tr>
<tr>
<td>MFI provided only Group based lending methodology.</td>
<td>50</td>
<td>2.76</td>
<td>.508</td>
</tr>
<tr>
<td>MFI are frequently reluctant to support poor people those want to expand their businesses with a loan</td>
<td>50</td>
<td>4.16</td>
<td>.551</td>
</tr>
</tbody>
</table>

*Source: Research Findings*

Findings from table 4.5 above present generally high agreement levels with the statements posed by the researcher as indicated by the high means. Another notable observation is that most MFIs are seen to prefer individual lending to group lending (X = 2.76, S.D = .508). This is normally associated with high loan defaulting among the loanees, a possible explanation of the high levels of defaulting experienced by the lending institutions. It can however be concluded that MFI loans lead to the improvement in productivity among the beneficiary SMEs, as well as profitability and the high number of entrepreneurs starting up new ventures.
4.3 Regression Analysis

To establish the effect of microfinance institutions to the growth of Small and Medium Enterprise in Somalia, a multiple regression analysis was conducted to establish the relative effect of microfinance institutions to the growth of Small and Medium Enterprise in Somalia. The regression model was as shown below:

\[ \text{ROA} = \alpha + \beta_1(\text{Accessibility of credit in MFI}) + \beta_2(\text{collateral of MFI lending}) + \beta_3(\text{Individual lending}) + \beta_4(\text{Group lending}) + \epsilon \]

Regression analysis also produced correlation, coefficient of determination and analysis of variance (ANOVA). Correlation sought to show the nature of relationship between dependent and independent variables and coefficient of determination showed the strength of the relationship. Analysis of variance was done to show whether there is a significant mean difference between dependent and independent variables. The ANOVA was conducted at 95% confidence level.

**Table 4.6 Model Goodness of Fit**

<table>
<thead>
<tr>
<th>R</th>
<th>R²</th>
<th>Adjusted R²</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>0.771</td>
<td>0.631</td>
<td>0.532</td>
<td>0.06227</td>
</tr>
</tbody>
</table>

a. Predictors: (Constant), Accessibility of credit in MFI, Collateral of MFI lending, Individual lending, and Group lending.

b. Dependent Variable: ROA

Regression analysis was used to establish the relationship between ROA and the factors that affects variables. The results showed a correlation value (R) of 0.771 which depicts
that there is a good linear dependence of ROA on accessibility of credit in MFI, collateral of MFI lending individual lending, group lending.

With an adjusted R-squared of 0.532, the model shows that accessibility of credit in MFI and collateral of MFI lending explain 53.2 percent of the variations in profitability while 46.8 percent is explained by other factors not in the model.

**Table 4.7: Analysis of Variance**

<table>
<thead>
<tr>
<th></th>
<th>Sum of Squares</th>
<th>Df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regression</td>
<td>4.181</td>
<td>3</td>
<td>1.394</td>
<td>3.135</td>
<td>.038a</td>
</tr>
<tr>
<td>Residual</td>
<td>15.562</td>
<td>35</td>
<td>.445</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>19.744</td>
<td>38</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

ANOVA statistics was conducted to determine the differences in the means of the dependent and independent variables thus show whether a relationship exists between the two. The P-value of 0.038 implies that profitability has a significant joint relationship with accessibility of credit in MFI and collateral of MFI lending which is significant at 5 percent level of significance. This also depicted the significance of the regression analysis done at 95% confidence level.
Table 4.8: Regression Coefficient Results

<table>
<thead>
<tr>
<th></th>
<th>Un-standardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>T</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Constant)</td>
<td>7.724</td>
<td>5.006</td>
<td>1.543</td>
<td>.132</td>
</tr>
<tr>
<td>Accessibility of credit in MFI</td>
<td>1.719</td>
<td>.720</td>
<td>.362</td>
<td>2.387</td>
</tr>
<tr>
<td>collateral of MFI lending</td>
<td>-1.434</td>
<td>.697</td>
<td>-.338</td>
<td>-2.058</td>
</tr>
<tr>
<td>Individual lending</td>
<td>.456</td>
<td>.827</td>
<td>.091</td>
<td>.551</td>
</tr>
<tr>
<td>Group lending</td>
<td>0.724</td>
<td>5.006</td>
<td>0.762</td>
<td>1.442</td>
</tr>
</tbody>
</table>

a. Dependent Variable: ROA

From the data in the above table, there is a positive relationship between ROA and accessibility of credit in MFI, a negative one between ROA and the collateral of MFI lending, and also a positive relationship between ROA and individual lending and group lending. The established regression equation was:

\[
\text{ROA} = 7.724 + 1.719 \times \text{Accessibility of credit in MFI} - 1.434 \times \text{collateral of MFI lending} + 0.456 \times \text{Individual lending} + 0.724 \times \text{Group lending} \quad P = 0.038
\]
4.4 Interpretation of Findings

This section attempts to provide vivid interpretation of the findings obtained relating to the objective of the study. To establish the effect of microfinance institutions to the growth of Small and Medium Enterprise in Somalia, a multiple regression analysis was conducted to establish the relative effect of microfinance institutions to the growth of Small and Medium Enterprise in Somalia. The results showed a correlation value (R) of 0.771 which depicts that there is a good linear dependence of ROA on accessibility of credit in MFI, collateral of MFI lending individual lending, group lending. ANOVA statistics was conducted to determine the differences in the means of the dependent and independent variables thus show whether a relationship exists between the two. The P-value of 0.038 implies that profitability has a significant joint relationship with accessibility of credit in MFI and collateral of MFI lending which is significant at 5 percent level of significance. This also depicted the significance of the regression analysis done at 95% confidence level.

The regression results show that, when accessibility of credit in MFI and collateral of MFI lending have zero values, the dependent value would be 7.724. It is also established that a unit increase in accessibility of credit in MFI in a 1.719 increase in ROA and a unit increase in collateral of MFI lending leads to a 1.434 decrease in profitability and so on. This statistic had a t-value of 2.387 at 0.023 showing that the statistic is significant at 95% confidence level. A t-value of -2.058 was established at 0.047 error margin. This shows that the statistics was significant at 95% significance level.
A positive relationship was established between ROA and accessibility of credit in MFI, a negative one between ROA and the collateral of MFI lending and a positive one between ROA and group lending individual lending. The regression results show that, when accessibility of credit in MFI, collateral of MFI lending, individual lending and group lending have zero values, the dependent value would be 7.724. Overall the findings indicate that only a small percentage of the SMEs in Somalia are beneficiaries of the MFI lending services.
CHAPTER FIVE
SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter summarizes the study and makes conclusion based on the results. The implications from the findings and areas for further research are also presented. This section presents the findings from the study in comparison to what other scholars have said as noted under literature review.

5.2 Summary

The study provided two types of data analysis; namely descriptive analysis and inferential analysis. The descriptive analysis helps the study to describe the relevant aspects of the phenomena under consideration and provide detailed information about each relevant variable. For the inferential analysis, the study used the panel data regression analysis and the Chi-square statistics. The study first evaluated the performance of the variables under consideration i.e. accessibility of credit in MFI and collateral of MFI lending. Their mean and standard deviation values were determined.

From descriptive statistics, the means suggest that a majority of the SMEs engage in either cloths (X = 6.45, S.D = .421) or electronics/accessories (X = 5.01, S.D = .498). Shoes (X = 2.43, S.D = .437) and the ‘others’ (X = 2.38, S.D = .461) categories recorded the lowest means suggesting a low number of SMEs engaging in the sectors. It also established that a majority of the SMEs source their capital from partnerships (X = 6.04, S.D = .567) followed by family sources (X = 4.51, S.D = .577). A relatively low number of SMEs get their capital from MFIs (X = 4.92, S.D = .498).
The study further sought to find out whether the SMEs benefiting from the MFI loans could afford availing the collaterals as required by the lending institutions. It was established that an overwhelming 33 (66.7%) of the respondents could not afford the collaterals. 39 (78%) of the respondents confirmed that indeed they faced challenges in acquiring loans. Asked on what challenges they faced included: length of time taken in processing the loans (X = 5.56, S.D = .433); raising collateral (6.12, S.D = .431); stringent repayment terms (X = 5.96, S.D = .574 and high transaction costs (X = 5.88, S.D = .523). The means and standard deviations of the responses are provided in table 4.4 above.

A notable observation was established that most MFIs are seen to prefer individual lending to group lending (X = 2.76, S.D = .508). It was also established that MFI loans lead to the improvement in productivity among the beneficiary SMEs, as well as profitability and the high number of entrepreneurs starting up new ventures. ANOVA statistics was conducted to determine the differences in the means of the dependent and independent variables thus show whether a relationship exists between the two. The P-value of 0.038 implies that ROA has a significant joint relationship with accessibility of credit in MFI and collateral of MFI lending which is significant at 5 percent level of significance. This also depicted the significance of the regression analysis done at 95% confidence level.

A positive relationship was established between ROA and accessibility of credit in MFI, a negative one between ROA and the collateral of MFI lending and a positive one
between ROA and group lending individual lending. The regression results show that, when accessibility of credit in MFI, collateral of MFI lending, individual lending and group lending have zero values, the space allocation value would be 7.724. It is also established that a unit increase in accessibility of credit in MFI in a 1.719 increase in ROA and a unit increase in collateral of MFI lending leads to a 1.434 decrease in ROA.

5.3 Conclusion
The study has established the effect of microfinance institutions to the growth of Small and Medium Enterprise in Somalia. Data have been analyzed by applying both descriptive and inferential. Only a small percentage of the SMEs in Somalia are beneficiaries of the MFI loaning services. It can also be concluded that most of the requirements as collateral for loan application cannot be afforded by most SMEs, hence opting for cheaper sources of capital hence the low adoption of the loan services by MFIs. Other challenges causing low adoption of the loans include: the long time taken processing loans, stringent repayment terms and the high transaction costs. MFI loans can be said to lead to the improvement in productivity among the beneficiary SMEs, as well as profitability and the high number of entrepreneurs starting up new ventures. There exists a positive relationship between ROA and accessibility of credit in MFI, a negative one between ROA and the collateral of MFI lending and a positive one between ROA and group lending and individual lending.
5.4 Recommendations for Policy

In view of the findings made and conclusions drawn from the study the following recommendations are provided to help enhance an accelerated and sustained growth in the SME sector and also provide recommendations to help in the improvement of the services of MFIs. There is need for the government and other partners to facilitate the accessibility of credit in Small and medium enterprises to the Microfinance Institutions and minimize the collateral conditions.

Finally, the researcher recommend that in order to reduce the rate of default, MFIs can research into very profitable business lines and offer credit to clients who have the capacity to exploit such business lines. SMEs should be encouraged also to adopt group financing so as to avert loan defaulting.

5.5 Limitations of the Study

Microfinance Institutions is relatively launched in Somalia shortly, therefore, the local studies is very limited according to the influence of Microfinance Institutions to the growth of Small and Medium enterprises.

The central government of Somalia has no power to control all the enterprises, therefore, there is no registration the Small and Medium in the country. Thus, there is no exact list of enterprises which operates in operates in the country.

Furthermore, collecting data from different enterprises is very hard because of insecurity and instability of the country; therefore, reaching the respondents would be difficult and
also there was no assurance that the respondents would return all the questionnaires duly completed.

5.6 Areas for Further Research

There is a need for further research to be undertaken the role of microfinance institutions to the economy of the country and also how they can contribute to the poverty reduction of the low income people.

An assessment of the effectiveness of MFI sponsored credit programmes for SME enterprises towards promotion of low income people in the country.

In addition, it will be interesting to explore ways the government can promote the accessibility of SMEs on credit of Microfinance Institutions.
REFERENCES


*Entrepreneurship Theory and Practice*, 16,(2) 13-22


Montogometry, R.(1996). "Disciplining or Protecting the Poor? Avoiding the social costs of Peer Pressure in Micro-Credit Schemes". Journal of international Development 8, 289-305


Nghehnevui, B. & Zachary, N. (2010). The impact of micro finance institutions (mfis) in the development of small and medium size businesses (SMEs). Cameroon: Cam CCUL.


APPENDICES

APPENDIX I: QUESTIONNAIRE

Instructions

Dear sir/madam

You are requested to complete this questionnaire as honestly and objectively as possible. Please tick in the appropriate box and also fill in the blank spaces provided for those questions where elaborate answers are required.

Your contribution is highly appreciated and important to this study.

SECTION (A): Profile of the respondents

I. Age
   a) 18-21 years  
   b) 22-26 years  
   c) 27-30 years  
   d) 31-Above years

II. Gender
   a) Male  
   b) Female

III. Type of enterprise

What type of business are you engaged in?

a) Electronics/Accessories  
   b) Cloths  
   c) Bookshops  
   d) Construction Sector  
   e) Service sector  
   f) Cosmetics  
   g) Shoes  
   h) Others please specify: __________________________
Section: (B) Credit accessibility of SMEs

1. What is (are) the source(s) of your business capital?
   A. Personal savings ( )
   B. Family ( )
   C. Loan from Microfinance Institutions ( )
   D. Partnership ( )
   E. Others (Please Specify): -

2. Do MFIs always require collateral before they give you loans?
   A. Yes ( )
   B. No ( )

3. Can you afford the collateral requested by MFIs?
   A. Yes ( )
   B. No ( )

4. Do you face any challenges in getting loan from MFIs?
   A. Yes ( )
   B. No ( )

5. If yes, kindly provide the challenges you face in getting loan from MFIs.
   ________________________________
   ________________________________
   ________________________________

Section: (C) SMEs Growth and MFI Lending

Please write your answer to the statements below. Kindly use the rating guided as follows:

1-Strongly disagree  2-Disagree  3- Natural
4- Agree  5- Strongly agree

Please tick in the blanks provided as your response  

58
<table>
<thead>
<tr>
<th>No</th>
<th>SCALE</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Microfinance institutions funds increases the profitability of the small and medium enterprise</td>
</tr>
<tr>
<td>2</td>
<td>MFIs contributed Increases the number of entrepreneurs who Starting new venture</td>
</tr>
<tr>
<td>3</td>
<td>SMEs increases their productivity through getting fund MFIs which leads enterprise growth</td>
</tr>
<tr>
<td>4</td>
<td>MFIs provide individual lending to the entrepreneurs of small and medium enterprise</td>
</tr>
<tr>
<td>5</td>
<td>MFIs provide only Group based lending methodology.</td>
</tr>
<tr>
<td>6</td>
<td>MFI are frequently reluctant to support poor people those want to expand their businesses with a loan</td>
</tr>
</tbody>
</table>
25 September 2013

TO WHOM IT MAY CONCERN

The bearer of this letter, ABDINOR DAHIR S. YAD

is a bona fide continuing student in the Master of Science in Finance (MSc. Finance) degree program in this University.

He/She is required to submit as part of his/her coursework assessment a research project report on a management problem. We would like the students to do their projects on real problems affecting firms in Kenya. We would, therefore, appreciate your assistance to enable him/her collect data in your organization.

The results of the report will be used solely for academic purposes and a copy of the same will be availed to the interviewed organisation on request.

Thank you.

JANE MUTURI
MSc. FINANCE ADMINISTRATOR
SCHOOL OF BUSINESS.
APPENDIX III: DATA COLLECTION SHEET

ABDINOR DAHIR SIYAD

University of Nairobi

School of Business

P.O. Box 30197

Nairobi

Dear Sir/Madam,

Ref: THE EFFECT OF MICROFINANCE INSTITUTION LENDING ON THE GROWTH OF SMALL AND MEDIUM ENTERPRISE IN SOMALIA

I am student at the University of Nairobi pursuing a Master of Science in Finance degree. I am undertaking the above research project in partial fulfillment of the stated degree. I am conducting a study on the above topic and your area has been chosen to participate of this study. The content of this data will be for academic purpose only. The confidentiality of the respondent will be highly respected. As a sign of appreciation for your participation, the findings and recommendations of the research will be availed to you upon completion.

Thanks you in advance

Yours faithfully

Abdinor Dahir