

**AN INVESTIGATION ON THE IMPACT OF INTEREST RATES ON FINANCIAL
SUSTAINABILITY OF MICROFINANCE INSTITUTIONS IN KENYA**

BY

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DECLARATION

This project is my original work and to the best of my knowledge, it has not been presented for the award of a degree in any other University.

Lucy Wangari

D61/62971/2011

Signature _____

Date_____

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

James M. Ng'ang'a

Signature _____

Date_____

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I wish to acknowledge the almighty God for enabling me this far with this project.

I owe my success to my supervisor James Ng'ang'a for offering thoughtful logic, providing me with the required guidelines of writing the project and ensured that the final report met the required standards.

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DEDICATION

I dedicate this project first to my husband who has supported me financially, psychologically and emotionally allowing me to take long hours to study and attend group works.

I also dedicate the project to my kids Ian and Melody for being my motivation to study.

ABSTRACT

The high interest rates charged by many MFIs have attracted the attention of concerned policymakers throughout the world. The main objective of the research study was therefore to establish the impact of interest rates on financial sustainability of MFIs. The literature review provides the reader with an explanation of the theoretical rationale of the problem being studied as well as what research has already been done and how the findings relate to the problem at hand. The study applied a descriptive research design and the target population was 129 respondents. The study applied a sampling technique to obtain a sample size of 65 respondents. Questionnaires were the major data collection instruments and the gathered findings were analyzed through the use of quantitative and qualitative analysis, tables were used to present the findings. The descriptive and inferential statistics was used in analysis of relationships, differences, trends and comparisons. The study found out that majority of respondents who were 50% indicated 5 years and below. The study findings found indirect relationship between cost and financial sustainability of MFIs; however the degree of relationship is weak. There was a direct relationship between interest rates and financial sustainability, the degree of relationship is strong. There is direct relationship between profitability and financial sustainability of MFIs, the degree of relationship is strong. The study recommended that the government should come up with better interest rates policies that will make MFIs more financial sustainable. Interest rates policies that are detrimental towards MFIs financial sustainability should be abolished. Interest rates policies in place should make the cost of borrowing loans from MFIs more affordable to most borrowers. Microfinance institutions should be able to meet its operational cost to be sustainable. MFI should be able to recruit, induct, train and maintain well-qualified staff who are capable of delivering the services as required.

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CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

1.1.1 Interest Rates

The role of interest rates in determining the sustainability of MFIs cannot be under-estimated. Resultantly, what drives an MFI to devise its interest rate policy becomes a question of immense importance. This formation of interest rates mainly depends on the financial performance and social objectives of an MFI. Consequently, the impact of financial and social efficiency of microfinance in shaping the interest rate policy, which ultimately has an effect on the sustainability of MFI (King, 2009). Johnson (2007) calls for integrating interest rates as a determinant of the sustainability while controlling for market structure is a step in the right direction.

Microfinance institutions were established to assist the low income earners by providing credit. In their provision of credit to low earners they charge interest rate which over the years has been high. Investors are often surprised by the seemingly high interest rates for small loans required by Microfinance Institutions (MFIs) in developing countries. Typical interest rates are in the range of 2 to 4% per month, which can lead to annualized interest rates in the range of 20 to 80%, depending on the scheme (Kotler, 2006). Microfinance practitioners have long argued that such high interest rates are simply unavoidable, because the cost of making each loan cannot be reduced below a certain level while still allowing the lender to cover costs such as offices and staff salaries. For example in Sub-Saharan Africa credit risk for microfinance institutes is very high, because customers need years to improve their livelihood and face many challenges during this time (Webster, 2006).

1.1.2 Financial Sustainability of MFIs

The sustainability of an MFI can be defined as its capacity to cover all of its expenses by its revenue and to generate a margin to finance its growth. It is the capacity of an MFI to carry out its activities without the need for subsidies in the form of concessional loans or donations. Nonetheless, a study by CGAP (1995) concludes that microfinance cannot be financially sustainable. It is generally believed that small loans are too costly to provide, and the resulting income is insufficient to ensure profitable operations (Dondo, 2010).

Kanga (2008) corroborate this hypothesis by showing that unlike financial institutions in the formal sector; most MFIs are not sustainable. They add that many MFIs could not function without the subsidies that they receive from governments and other funders. This view is shared by Peil (2005), who contend that because of the high cost of providing microfinance products and services, most MFIs are not sustainable and are thus reliant on donor subsidies.

The micro finance industry had for a long time operated under a number of constraints such as: lack of legal framework, weak institutional capacity and unsustainable sources of funding among others. The combination of these factors led to uncompetitive and inefficient micro finance industry and to the failure of some MFIs. Kenya Government has progressively made efforts to address these challenges as evident in Sessional Paper No.1 of 1986, Sessional Paper No.2 of 1992, Sessional Paper No.2 of 2005, National Poverty Eradication Plan 1999-2015 and more recently, Microfinance Act 2006 which became operational from May 2008 (Kimenyi, 2009).

The need for the sustainability of MFI's remains an area of interest for practitioners, creditors, donors and other stakeholders in the micro finance industry. Sustainability is widely regarded as the best practice in the micro finance industry and MFIs themselves are increasingly seeing it as a core element of their business strategy. The focus on financial sustainability is attributed to its conformity that only independent and financially sustainable Micro Finance Institution's will be able to extend their services to the poor on a wide scale to achieve highest level of impact, based on an affordable model that does not depend on long-term support, either from donors or the government. Some of the measures taken by organizations in achieving sustainability includes use of performance ratios, clear governance structures, internal controls , economies of scale and moving from depending on one source of income (Murugu, 2008).

1.1.3 Impact of Interest Rates on Financial Sustainability of MFIs

Interest rates are the main determinant of investment on a macroeconomic scale, if interest rates increase across the board, then investment decreases, causing a fall in national income. A government institution, usually a central bank, can lend money to financial institutions to influence their interest rates as the main tool of monetary policy. Usually central bank interest rates are lower than commercial banks interest rates since banks borrow money from the central bank then lend the money at a higher rate to generate most of their profit. By altering interest rates, the government institution is able to affect the interest rates faced by everyone who wants to borrow money for economic investment. Investment can change rapidly in response to changes in interest rates and the total output (King, 2009).

Each macroeconomic objective requires a separate policy instrument: The usual ‘rule of thumb’ is that one main policy instrument should be assigned to one policy objective. So, for example, interest rates might be assigned as the main instrument for keeping control of inflation, whilst fiscal policy instruments such as changes to the tax system might be allocated to achieving some supply-side objectives such as increasing the labour supply, boosting incentives, raising investment and increasing productivity. There are quite deep-rooted disagreements between some economists (who belong to different ‘schools of thought’) as to which policies are most effective to meet a certain objective (World Bank, 2009).

Changes in economic policies are subject to uncertain time lags e.g. a change in interest rates is estimated to take some 18-24 months to work its way fully through the whole economy to filter through to a change in prices. The length of the time lags can change over the years as the reactions of consumers and businesses to policy measures (Ames, 2009).

The high interest rates charged by many MFIs have attracted the attention of concerned policymakers throughout the world. Governments have used mandatory interest rate ceilings to protect clients from the ill effects of predatory lending. Interest rate ceilings often hurt rather than protect the most vulnerable by shrinking poor people's access to financial services. Ceilings can also lead to less transparency about the costs of credit, as lenders cope with interest rate caps by adding confusing fees to their services. Promoting competition and consumer protection measures may be better policy alternatives. A new

CGAP Occasional Paper aims to shed some light on the relationship between interest rate ceilings and microfinance (Esipisu, 2006).

1.2 Research Problem

Microfinance is touted as the solution to the wide spread poverty in most developing countries, however, some people have been wondering how MFIs can fulfill their social obligations while charging their clients interest rates that are higher than those offered by non-microfinance institutions such as traditional commercial banks. Interest rate ceilings are found in many countries throughout the world. With the expansion of microfinance in developing countries, many legislators and the general public have found it difficult to accept that small loans to poor people generally cost more than normal commercial bank rates.

One of the principal challenges of microfinance is providing small loans at an affordable cost. The global average interest and fee rate is estimated at 37%, with rates reaching as high as 70% in some markets. The reason for the high interest rates is not primarily cost of capital. Indeed, the local microfinance organizations that receive zero-interest loan capital from the online micro lending platform Kiva charge average interest and fee rates of 35.21%. Rather, the main reason for the high cost of microfinance loans is the high transaction cost of traditional microfinance operations relative to loan size.

Policymakers in Kenya have been concerned about the effects of the seemingly high interest rates typically charged by microfinance institutions (MFI) lending money to poor people. Available data indicates that microfinance interest rates typically fall between 20 and 50 per cent per year (in places where inflation runs no higher than 10 per cent per year). It has been argued that such interest rates can erode surpluses generated by borrowers, leaving them with little net gain. But whilst experts agree that high interest rates intuitively make it more difficult for poor people to repay micro loans, in practice there is little evidence of these effects, and little research has been done in this area and therefore the need to carry out the study on the impact of interest rates on financial

sustainability. The study will try to identify what effect interest rates have on financial sustainability of MFIs, how interest rates affect cost among MFIs and how interest rates affect profitability of MFIs.

1.3 Research Objective

1.3.1 General Objectives

The main objective of the study is to investigate the impact of interest rates on financial sustainability of MFIs.

1.4 Value of the Study

Microfinance Institutions Managers

The study findings are of great importance to micro finance institution managers as they will be enlightened on the impact of interest rates on financial sustainability of MFIs. This will ensure that the main objective of the study has been accomplished as the impact of interest rates on financial sustainability of MFIs in Kenya will have been established.

The Government

The study findings will bring into perspective how interest rates affect sustainability of microfinance institutions which will enable the government to address interest rates so as to enable sustainability of microfinance institutions.

Loan Borrowers

The study findings are of great benefit to the borrowers of microfinance institutions as the implementation of recommendations on interest rates will make it easier for the borrowers to access credit.

Scholars and other Researchers

The study will provide the background information to other researchers and scholars who may want to carry out further research on the impact of interest rates on financial sustainability. The study will facilitate individual researchers to identify gaps in the current research work and carry out further research in those areas.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

The literature review provides the reader with an explanation of the theoretical rationale of the problem being studied as well as what research has already been done and how the findings relate to the problem at hand. The main purpose of the literature review is to avoid unnecessary or intentional duplication of materials already covered. The literature will be reviewed from, working papers, journals, books, reports, periodicals and internet sources. The past studies, theoretical review, critical analysis and research gaps will be discussed.

2.2 Theoretical Underpinning of the Study

These sections will discuss three major theories namely Irving Fisher's theory, the Abstinence or Waiting Theory of Interest and the Austrian or Agio Theory of Interest which will help to better understand the context of the research problem.

2.2.1 Irving Fisher's theory

Irving Fisher's theory of interest rates relates the nominal interest rate i to the rate of inflation π and the "real" interest rate r . The real interest rate r is the interest rate after adjustment for inflation. It is the interest rate that lenders have to have to be willing to loan out their funds. The relation Fisher postulated between these three rates is:

$$(1+i) = (1+r) (1+\pi) = 1 + r + \pi + r \pi$$

This is equivalent to:

$$i = r + \pi (1 + r)$$

Thus, according to this equation, if π increases by 1 percent the nominal interest rate increases by more than 1 percent.

This means that if r and π are known then i can be determined. On the other hand, if i and π are known then r can be determined and the relationship is:

$$1+r = (1+i) / (1+\pi)$$

or

$$r = (i - \pi) / (1+\pi)$$

When π is small then r is approximately equal to $i-\pi$, but in situation involving a high rate of inflation the more accurate relationship must be taken into account.

2.2.2 The Abstinence or Waiting Theory of Interest

According to abstinence theory, interest is a reward for abstinence. When a person saves money from his income and lends it to somebody else, he in fact makes sacrifice. Sacrifice in the sense, which he abstains from consuming the whole of his income which he could have easily spent. As abstaining from consumption is disagreeable and painful, so the lender must be rewarded for this. Thus, according to Senior (2007), interest is the reward for abstinence from the use. This theory is rejected on the ground that saving does not necessarily involve discomfort or sacrifice. A millionaire may save and lend a major part of his income without undergoing any hardship or suffering.

Marshall (2008), realizing this flaw in Senior's definition, substituted the term waiting for abstinence. According to Marshall, interest is the reward for waiting. When a man saves a

part of his income, he simply postpones his present consumption to some future date. During a period when money is loaned, he himself might stand in need of money. But he cannot get it back from the borrower as the period of loan is fixed. He has to wait for the return of loan. In order to encourage the spirit of waiting amongst the lenders, some inducement is necessary and this inducement according to Marshall is interest.

2.2.3 The Austrian or Agio Theory of Interest

The Austrian or Agio Theory of interest was first advanced by John Rao in 1834 and later on, it was developed by the Austrian economist, Bohm-Bowork. According to Bohm-Bowork, Interest is the premium or agio which present goods command over future goods. *First* Future is shrouded in mystery and so is uncertain. *Secondly*, present wants are more urgently felt than the future ones. *Thirdly*, present goods possess a technical superiority over future goods. Keeping in view all the conditions stated above, an individual prefers present satisfaction to a future satisfaction.

2.2.4 Different Dimensions of Sustainability

Institutional sustainability looks at those dimensions of the organization, which deals with the internal organizational environment. These are the dimensions that make the organization a wholesome, vibrant and a going concern. Sustainability of its mission is what will keep the organization in its chosen path in the long term. Activities that the organization is engaged in have to be constantly evaluated for its compatibility with the defined mission of the organization. If changes are brought about in the mission, it would be through a well articulated and participatory process in the organization (Dondo, 2010).

Programme sustainability occurs when stakeholders (clients) perceive that the services that they are receiving are of sufficient importance and value and are willing to assume responsibility and ownership for them. When this occurs the MFI can develop a phasing out strategy because the programme remains client supported and no externally subsidized support is sought (Webster, 2006).

It means that the MFI is able to recruit, induct, train and maintain well-qualified staff who are capable of delivering the services as required. Also the staff is able to monitor and maintain the organization on the right track, keeping in mind all the other parameters of sustainability. Financial sustainability means that the MFI is able to cover all its present costs and the costs incurred in growth, if it expands operations. It would mean that the MFI is able to meet its operating costs, its financial costs adjusted for inflation and costs incurred in growth (Wamavumo, 2008).

Market sustainability as described above assumes the existence of a stable and friendly legal and policy environment that will enable the proliferation of a large number of organizations involved in the delivery of Microfinance services. It would deal with issues relating to legal forms of organizations, interest rates, savings mobilization, and resource mobilization from capital markets, from overseas commercial sources (Peil, 2005).

Microfinance has emerged as an effective methodology for alleviation of poverty among the disadvantaged sections. Thus it is necessary that the services delivered by the different organizations have a positive impact on poverty. The positive changes that occur in the life of the poor family have to be sustained over the long term for the family to gradually emerge out of the state of poverty (Yunus, 2006).

2.3 Empirical Studies

Microfinance promises not only poverty reduction but also financial sustainability. After almost four decades into the business this promise is yet to be fulfilled because the role of the subsidies still persists which hinders the Microfinance (MFIs) to achieve self-sustainability. According to CGAP research, the stock of foreign capital investment in the microfinance sector more than tripled to \$4 billion between year 2004 and 2006, much of it drawn by microfinance strong profit growth and reputation for doing good. This interest is driving big changes in the industry: it is forcing MFIs to become more commercial, to restructure them, to come to terms with a wider world (Bornstein, 2008).

Davis (2007) found evidence of the possibility of earning profits while serving poor, but a trade-off emerges between profitability and serving the poorest using data of the 124

MFIs in 49 countries. They have defined the sustainability by the traditional financial ratios of Operational Self-Sustainability (OSS) and Return on Assets (ROA) in their paper. Davis (2007) looks at the issue from purely financial aspect by investigation the effects of subsidization on the financial efficiency of 79 microfinance institution where the subsidy intensity covers only subsidies in the form of equity. The main drawback of all the existing studies is lack of reliability of the data due to small sample size mainly concentrating in one region and the accuracy of the subsidy figures in measuring sustainability. Bank on the high quality cross-country panel data set for 179 MFIs in 54 countries worldwide, this paper attempts to fill that void by taking on these issues in more definitive way on much larger scale.

Investigation into the determinants of the profitability of microfinance is also an interesting research avenue in microfinance. Conventionally, profitability is defined in term of traditional financial ratio i.e. operational self-sufficiency and return of assets etc. This paper goes beyond and takes also Subsidy Dependence Index (SDI) as a measure of profitability. Some MFIs charge their clients exorbitant interest rates. Doyle (2008) calls them Micro loan Sharks involved in not micro lending but micro loan-sharking. Gibbons (2009) found evidence that raising interest rates resulted in increased profitability for individual based lending MFIs whereas for solidarity based lenders, the reverse is true. This paper also found evidence that raising the interest rates leads to improved financial performance and profitability with lower subsidy dependence and higher operational self sufficiency. Whereas rising costs are associated with lower profitability.

2.4 Summary and Gaps to be filled

This chapter discusses the literature review of the study; the empirical review explains the past studies previously undertaken on the impact of interest rates on financial sustainability. The theoretical review discusses the major past activities that addressed the variables stated by the study objectives, this makes the study to explore widely on the

past efforts that have been undertaken on the impact of interest rates on financial sustainability. Critical analysis was made and gaps discussed.

There are many the impact of interest rates on financial sustainability of MFIs, some of these factors have been explored by past researchers and were explained in the empirical review of the study. However, the major policy effects that are addressed by the study objectives have not been adequately explored and this leaves some major gaps that need to be filled by further research undertakings. There exist interest rates and credit access gap. The past studies failed to clearly show how interest rates affect financial sustainability of MFIs, the current study will recommend how the government can regulate interest rates to improve MFIs financial sustainability and help fill interest rates gap.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter brings out the research design and methodology. These are the steps taken in the data collection, and analysis. The section contains the research instruments which the researcher incorporated in the study. In addition to that, the sampling design and the data collection procedures will be important components of a research and will also be contained in this chapter. This section of the study also described the data collection instruments, the target population and the sampling method, procedure of data collection and data analysis in totality.

3.2 Research Design

The study utilized descriptive research method, which was the most applicable for the study, as the study focused on describing independent variables. This scientific method of investigation involved collection and analysis of data in order to describe a phenomenon in its current condition. Descriptive research is a process of collecting data in order to test hypothesis or to answer questions concerning the current status of the subjects in the study (Mugenda and Mugenda, 2003). This is because, it is time saving, it was possible and easy for the researcher to obtain current factual information from the employees in the organizations, and again it is a cheaper method of studying the organization and coming up with accurate and well arranged findings.

3.3 Population

The target population was obtained from microfinance institutions operating in Nairobi, by the end of December 2011. According to Association of Microfinance institutions, there are 43 microfinance institutions operating in Nairobi. The study targeted chief executive officers, Program officers and Finance officers working in the selected microfinance institutions in Nairobi which translate to 43 chief executive officers, 43 programme officers and 43 finance officers. The study therefore targeted 129 respondents. The target population was appropriate because it enabled the study to get the required information on impact of interest rates on financial sustainability of MFIs.

3.4 Sample

A sampling technique refers to the procedures used to select a representative sample from the target population (Kothari, 2009). Stratified random sampling technique was used to select respondents from selected MFIs as it enabled generalization of a larger population with a margin of error that is statistically determinable. Stratified sampling is appropriate for this survey because the population was heterogeneous where the stratas are mutually exclusive.

According to Kothari (2009), if a population from which a sample to be drawn does not constitute a homogeneous group, stratified sampling technique is generally applied in order to obtain a representative sample. Under stratified sampling, the population is divided into sub-groups (strata) and items are selected randomly from each stratum to constitute a sample. This method enabled the researcher to select respondents who provides reliable information on impact of interest rates on financial sustainability.

According to Mugenda (2008), the sample size selected should not be less than 50% of the target population so as to enable generalization of the research findings which increased the validity of the gathered data; the sample size selected should not have less than 30 cases for correlation research. The sample was 65 respondents.

The sample size was appropriate because it represent a good number of respondents who provided the required information that was critical towards fulfillment of the main objective of the study. This involved the extent to which the respondents were picked from target population .The sampling size is the number of respondents who were selected and issued with the questionnaires. The sampling method was stratified random sampling.

3.5 Data collection

These included the various methods of collecting data that was applied to gather raw data from the field before it is presented for analysis and tabulation; in this study, questionnaires were utilized to collect primary data.

Questionnaires were issued on random basis to the selected respondents. Questionnaires are written statements which are asked to the respondents with an intention of getting feedback that was used as a primary data from the field of study. The study used two types of questionnaires as major data collection instruments which were structured and unstructured. Structured questionnaires list close-end questions. These included multiple choice questions which offer respondents the ability to answer “yes” or “no” or choose from a list of several answer choices (Joan, 2009).

Close ended questions also include scales refer to question that ask respondents to rank their answers at a particular point on a scale. Unstructured questionnaires have open ended questions where respondents can answer in their own words. To test for validity and reliability of data collection instruments a piloting study was done by giving questionnaires to five respondents. Questionnaires were distributed via e-mails and through posts (Joan, 2009).

This presented the actual data that was gathered for the purpose of the research study; it includes questionnaires, recorded interviews and observed issues. This type of data was collected fast and then analyzed to get only the important information for proper judgmental analysis. The various sources of primary data used will be questionnaires were mostly be used and they were the major data collection instruments that was applied.

This was the data that was collected for other purpose but it was still be usable in this type of research study, it involved past data that had been previously collected and tabulated through use graphs, charts and reports. This type of data was collected from reference materials, which had key information that was helpful to this research study. Collection of secondary data was obtained through desk research, which was either in from internal or external sources, the external sources included publications marketing research agency, press, newspapers, libraries, and various research related organization. As explained by Mugenda and Mugenda (2003), the purpose of pre-testing the instruments is to ensure that the items in the instruments are stated clearly and have the same meaning to all respondents. Questionnaires were pilot tested in the three categories of the target population which were randomly selected.

3.6 Data Analysis

The data collected was largely quantitative and hence quantitative analysis techniques such as graphs, charts and statistical techniques was used in data analysis. The descriptive and inferential statistics was used in analysis of relationships, differences, trends and comparisons. Key to the research was establishing the relationship between interest rates and financial sustainability, cost and profitability. Pearson Product of Correlation Coefficient was used to determine the magnitude and direction of the relationship between the factors (independent variables) and (dependent variable).

The basis of using this model is because it's a measure of the linear correlation between two variables. It measures the degree of linear dependence between two variables.

The relationship equation was as shown below-

$$Y = a + Bx + e$$

$$FS = a + B_1 C + B_2 I + B_3 P + e$$

Where:

FS= Financial Sustainability which is the dependent variable

a= Minimum value of the dependent variable if all the independent variables are zero

B₁= Coefficient of Cost (C)

B₂= Coefficient of interest rates (I)

B₃= Coefficient of Profitability (P)

e=Error variable

Financial sustainability was measured using the following indicators;

- Number of new customers
- Number of years without losses
- Gross profit in % over a number of years
- Rate of increase in income over the last years
- Cost reductions achieved during the past years

The model helped to better understand which among the independent variables are related to the dependent variable and to explore the form of their relationship

CHAPTER FOUR

4.0 DATA ANALYSIS, PRESENTATION AND INTERPRETATIONS

4.1 Introduction

This chapter discusses data analysis and presentation of the research findings, the chapter gives a detailed explanation of the processes, techniques and procedures applied to analyze and present data acquired through the use of the questionnaires. The chapter begins with the analysis of the response rate where the actual number of respondents who participated in the study was determined. The data obtained under each research variable was analyzed independently through the use of quantitative analysis and qualitative analysis to enhance high data validity. The study distributed 65 questionnaires to various MFIs. Out of the targeted 65, 60 responded making a response rate of 92% were received from respondents.

4.2 Demographic Characteristics of the Respondents.

Table 4.2 How Long the MFI has been Operating

Category	Response	Percentage
5 years and below	30	50
6-10 yrs	22	36
11-20yrs	5	8
20 years and above	3	5
Total	60	100

Figure 4.2 How Long MFI has been Operating

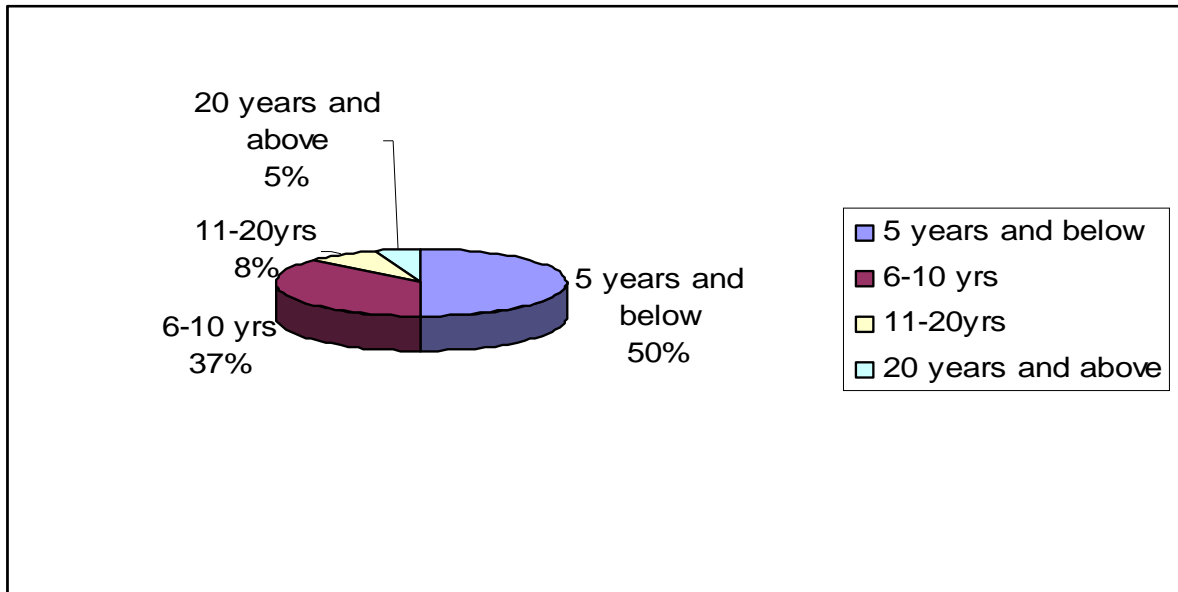


Table and figure 4.2 above shows how long MFI has been operation, majority of respondents who were 50% indicated 5 years and below, 37%(6-10) years, 8%(11-20) years and 5% 20 years and above which shows that most MFIs have not been operating for a long time.

Table 4.3 Services Offered by MFIs

Category	Response	Percentage
Credit provisions	33	55
Savings	20	33
Consultation/Advisory	7	12
Others Specify	0	0
Total	60	100

Figure 4.3 Services Offered by MFIs

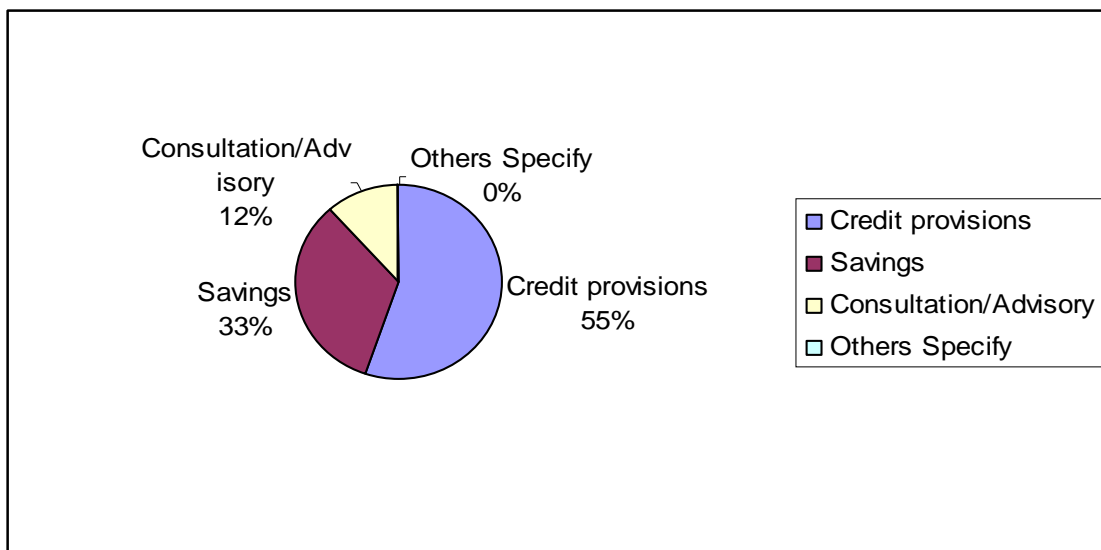
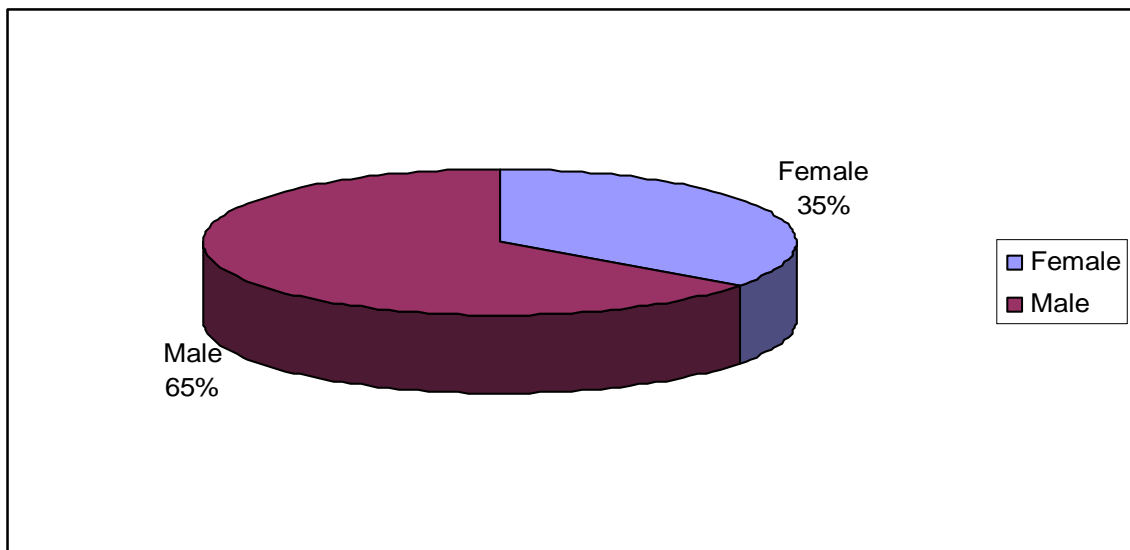


Table and figure 4.3 above shows the services offered by MFIs, majority of respondents who were 55% indicated credit provisions, 33% savings, and 12% consultancy and advisory services most MFIs were involved in credit provisions.

Table 4.4 Gender

Category	Frequency	Percentage
Female	21	35
Male	39	65
Total	60	100

Figure 4.4 Gender



The issue of gender was important in the study as it would indicate whether there was gender balance in the responses given. Table and figure 4.4 shows majority of respondents were male which was 65% of the total response rate and 35% of the respondents who were female which shows that there were more females than males who had knowledge on the impact of interest rates on financial sustainability of MFIs.

Table 4.5 Age of the Respondents

Category	Response	Percentage
18-30yrs	31	52
31-40 yrs	23	38
41-50yrs	4	7
Above 51 yrs	2	3
Total	60	100

Figure 4.5 Age of the Respondents

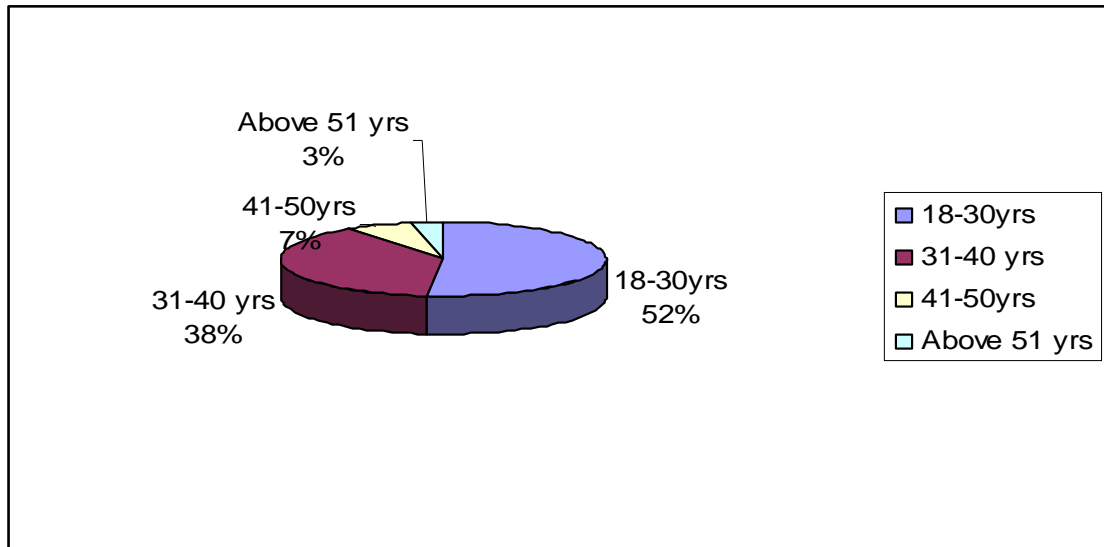


Table and figure 4.5 shows the age of respondents who participated in the research study. Majority of the respondents who were 52% were in the age bracket of 18-30 years, 38% (31-40), 7% (41-50) and 3% above 51 years. This indicated that majority of respondents involved in the organizations were young people who answered questions on the impact of interest rates on financial sustainability of MFIs. This is a clear indication that the

youth are actively involved in the management of the MFIs and have a thorough understanding of their operations.

Table 4.6: Highest Education Level

Category	Response	Percentage
Secondary Level	7	12
College level	23	38
University level	30	50
Total	60	100

Fig 4.6: Highest Education Level

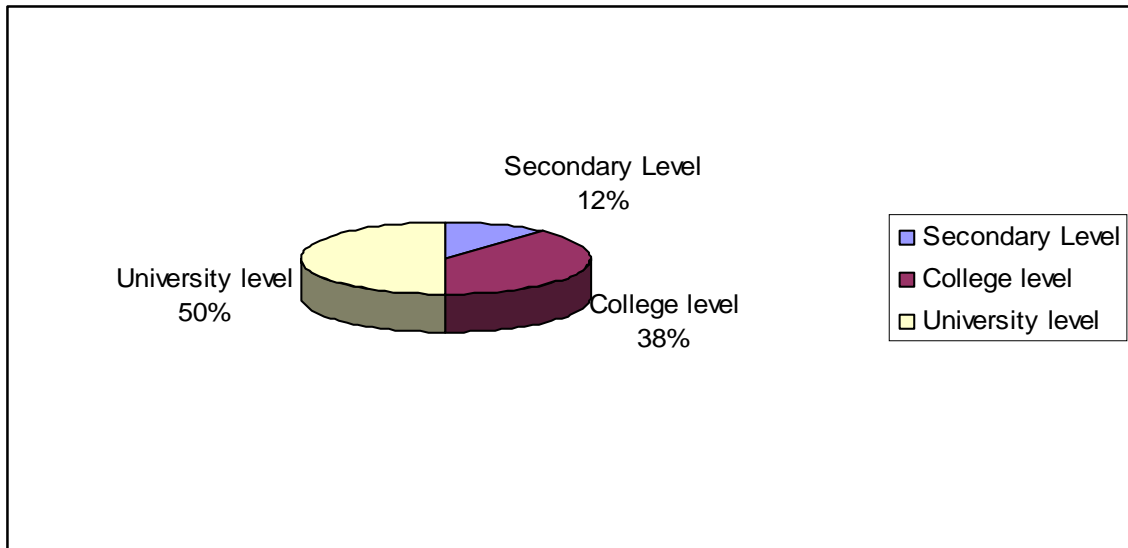


Table and figure 4.6 above shows the highest education level of respondents, majority of respondents who were 50% indicated university level, 38% college level and 12% secondary level which shows that the institutions had knowledgeable staff who understood the impact of interest rates on financial sustainability of MFIs.

4.3 Descriptive statistics for Interest Rates

The respondents had mixed opinions on effect of interest rates on sustainability of MFIs. Interest rates determined financial sustainability MFIs. Interest rates were indicated to be high by most respondents which was 2.50. Interest rates on loans were indicated to be high by most respondents which was 2.50. Interest rates affected income of MFIs which was 1.70. There are policies in place against interest rates ceilings which was 1.50.

Table 4.7 Interest Rates

Interest Rates	Mean
Interest rates determines financial sustainability of your institution	1.33
Interest rates on loans are high	2.50
Interest rates affect income of MFIs	1.70
There are policies in place against interest rates ceilings	1.50

4.4 Descriptive Statistics for Financial Sustainability

Interest rates affected financial sustainability of MFIs; most respondents indicated interest rates to affect financial sustainability in MFIs. Most respondents indicated MFIs to generate enough revenue which was indicated by 1.33. On whether the institution provides loan to the poor was indicated by 1.67. On whether the institution has clear governance structure was indicated by 1.50.

Table 4.8 Financial Sustainability

Financial Sustainability	Mean
The institution generate enough revenue	1.33
The institution provides loan to the poor	1.67
The institution has clear governance structures	1.50

4.5 Descriptive statistics for Cost

Interest rate was indicated to affect cost lending loans hence financial sustainability of microfinance institutions. On whether the organization was able to meet its operational cost, most respondents indicated 1.33 and on whether the cost of borrowing was high, most respondents indicated 2.50.

Table 4.9 Cost

COST	Mean
The organization is able to meet its operational cost	1.33
The cost of borrowing loan is high	2.50

4.6 Descriptive statistics for Profitability

Interest rates influenced financial sustainability and profitability of the firm. Most respondents indicated profitability to be affected by changes in interest rates. Some respondents indicated the organization to be profitable. Other respondents were the opinion that the organization has diversified their sources of income.

Table 4.10 Profitability

Profitability	Mean
The organization is profitable	1.50
The organization has diversified sources of income	1.00
Profitability is affected by changes in Interest rates	1.70

4.7 Correlation Matrix

Correlation is the degree of relationship between two variables. It is a relative measure of value and it ranges from negative one to positive one. Negative correlation implies that two variables are moving in opposite directions while positive correlation implies that they are moving in the same direction.

Table 4.11 Correlation

Correlations

		Cost	Interest Rates	Profitability	Financial Sustainability
Cost	Pearson Correlation	1	-.284*	-.153	-.296*
	Sig. (2-tailed)		.028	.242	.021
	N	60	60	60	60
Interest Rates	Pearson Correlation	-.284*	1	.497**	.489**
	Sig. (2-tailed)	.028		.000	.000
	N	60	60	60	60
Profitability	Pearson Correlation	-.153	.497**	1	.950**
	Sig. (2-tailed)	.242	.000		.000
	N	60	60	60	60
Financial Sustainability	Pearson Correlation	-.296*	.489**	.950**	1
	Sig. (2-tailed)	.021	.000	.000	
	N	60	60	60	60

*. Correlation is significant at the 0.05 level (2-tailed).

**. Correlation is significant at the 0.01 level (2-tailed).

There is an indirect relationship between cost and financial sustainability of MFIs as shown in the above table; however the degree of relationship is weak. This implies that for MFIs to reach sustainability, they must be in a position to cater for operational cost. The relationship is significant ($r = -0.296$, $P < 0.01$) thus cost determines the level of financial sustainability among MFIs. This view is shared by Peil (2005), who contend that because of the high cost of providing microfinance products and services, most MFIs are not sustainable and are thus reliant on donor subsidies.

There is a direct relationship between interest rates and financial sustainability, the degree of relationship is strong. This implies that changes in interest rates by the government directly affects financial sustainability of MFIs. The relationship is significant ($r = 0.489$, $P < 0.01$) thus interest rates determines the level of financial sustainability among MFIs. The study findings agree with (King, 2009) that by altering interest rates, the government institution is able to affect the interest rates faced by everyone who wants to borrow money for economic investment. Investment can change rapidly in response to changes in interest rates and the total output

There is direct relationship between profitability and financial sustainability of MFIs, the degree of relationship is strong. This implies that for MFIs to be financial sustainable they must be profitable. The relationship is significant ($r = 0.950$, $P < 0.01$) thus profitability determines the level of financial sustainability among MFIs. This view is shared by Peil (2005), who contend that because of the high cost of providing microfinance products and services, most MFIs are not sustainable and are thus reliant on donor subsidies.

4.8 Regression Analysis

Regression analysis usually enables confirmation of relationships between the independent and dependent variables since not all factors that are found to be significant in the correlation analysis influence the dependent variables. On conducting the regression analysis on the identified variables which were interest rates, financial sustainability, cost and profitability the following results were obtained as discussed below.

Table 4.12 Model Summary

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.962 ^a	.926	.922	.13796

a. Predictors: (Constant), Profitability, Cost, Interest Rates

The R value which is the correlation coefficient was 0.962 as shown in table above meaning there was a relationship between interest rates, cost and profitability as independent variables with Financial Sustainability as the dependent.

The co-efficient of determination (R^2) indicated a value of 0.922; this indicates that about 92.2% of the variation is explained by the predictor (independent) variables while the remaining proportion of 7.8% could be explained by other factors and also by chance or error.

Table 4.13 Anova**ANOVA^b**

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	13.367	3	4.456	234.095	.000 ^a
	Residual	1.066	56	.019		
	Total	14.433	59			

a. Predictors: (Constant), Profitability, Cost, Interest Rates

b. Dependent Variable: Financial Sustainability

From the ANOVA statistics in table above, the processed data, which is the population parameters, had a significance level of 0.000 which shows that the data is ideal for making a conclusion on the population's parameter as the value of significance.

Table 4.14 Coefficients**Coefficients^a**

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	.394	.141		2.787	.007
	Cost	-.151	.036	-.159	-4.197	.000
	Interest Rates	-.023	.045	-.022	-.511	.611
	Profitability	.941	.042	.937	22.372	.000

Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	.394	.141		2.787	.007
	Cost	-.151	.036	-.159	-4.197	.000
	Interest Rates	-.023	.045	-.022	-.511	.611
	Profitability	.941	.042	.937	22.372	.000

a. Dependent Variable: Financial Sustainability

On the correlation of the study variables, as shown in table 4.14 the one of the standard beta values is negative meaning the contribution of the independent variables and the dependent variables move in the opposite direction. As evidenced in table 4.9 means interest rates and financial sustainability have significance values ($P > 0.01$) meaning the three independent variables contribute significantly to the model. This is consistent with the correlation analysis done above and it confirms the correlation results.

The value of 0.394 shown in table 4.9 is the constant value. This is the minimum of the dependent variable in a situation where all the independent variables are zero. The coefficients of cost was -0.151. The coefficient of interest rates was -0.23. The coefficients for one of the dependent variables was negative indicating that interest rates move in opposite direction with financial sustainability. The value of 0.941 was positive indicating profitability move in the same direction with financial sustainability.

4.9 Summary and Interpretation of Findings

From the regressions, the study findings found indirect relationship between cost and financial sustainability of MFIs shown on the table, however the degree of relationship is weak. This implies that for MFIs to reach sustainability, they must be in a position to cater for operational cost.

There was a direct relationship between interest rates and financial sustainability, the degree of relationship is strong. This implies that changes in interest rates by the government directly affects financial sustainability of MFIs. There is direct relationship between profitability and financial sustainability of MFIs, the degree of relationship is strong. This implies that for MFIs to be financial sustainable they must be profitable.

On the relationship between cost and financial sustainability of MFIs the view was shared by Peil (2005), who contend that because of the high cost of providing microfinance products and services, most MFIs are not sustainable and are thus reliant on donor subsidies, he added that many MFIs could not function without the subsidies that they receive from governments and other funders.

On relationship between interest rates and financial sustainability, the study findings agree with (King, 2009) that by altering interest rates, the government institution is able to affect the interest rates faced by everyone who wants to borrow money for economic investment. Investment can change rapidly in response to changes in interest rates and the total output

On the relationship between profitability and financial sustainability of MFIs, This view is shared by Peil (2005), who contend that because of the high cost of providing microfinance products and services, most MFIs are not sustainable and are thus reliant on donor subsidies.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

The purpose of this chapter is to summarize the study findings and draw conclusions of the study carried out to establish the impact of interest rates on financial sustainability of MFIs. The researcher also pointed out the study recommendations and recommended.

5.2 Summary

On how long MFIs have been operating, majority of respondents who were 50% indicated 5 years and below, 37%(6-10) years, 8%(11-20) years and 5% 20 years and above which shows that most MFIs have not been operating for a long time. On services offered by MFIs majority of respondents who were 55% indicated credit provisions, 33% savings, and 12% consultancy and advisory services most MFIs were involved in credit provisions.

On gender issue majority of respondents were male which was 65% of the total response rate and 35% of the respondents who were female which shows that there were more females than males who had knowledge on the impact of interest rates on financial sustainability of MFIs.

Majority of the respondents who were 52% were in the age bracket of 18-30 years, 38% (31-40), 7% (41-50) and 3% above 51 years. This indicated that majority of respondents involved in the organizations were young people who answered questions on the impact

of interest rates on financial sustainability of MFIs. This is a clear indication that the youth are actively involved in the management of the MFIs and have a thorough understanding of their operations. On highest education level, majority of respondents who were 50% indicated university level, 38% college level and 12% secondary level which shows that the institutions had knowledgeable staff who understood the impact of interest rates on financial sustainability of MFIs.

The study findings found indirect relationship between cost and financial sustainability of MFIs shown on the table, however the degree of relationship is weak. This implies that for MFIs to reach sustainability, they must be in a position to cater for operational cost. There was a direct relationship between interest rates and financial sustainability, the degree of relationship is strong. This implies that changes in interest rates by the government directly affects financial sustainability of MFIs. There is direct relationship between profitability and financial sustainability of MFIs, the degree of relationship is strong. This implies that for MFIs to be financial sustainable they must be profitable.

5.3 Conclusions

From the findings it can be concluded that most MFIs have not been operating for a long time. Credit provision was the service mostly offered by MFIs. There were more females than males who had knowledge on the impact of interest rates on financial sustainability of MFIs. Respondents involved in the organizations were young people who answered questions on the impact of interest rates on financial sustainability of MFIs. Most respondents were educated and were knowledgeable on the impact of interest rates on financial sustainability of MFIs.

For MFIs to reach sustainability, they must be in a position to cater for operational cost. Because of the high cost of providing microfinance products and services, most MFIs are

not sustainable and are thus reliant on donor subsidies. Changes in interest rates by the government directly affects financial sustainability of MFIs, thus interest rates determines the level of financial sustainability among MFIs. Altering interest rates, the government institution is able to affect the interest rates faced by everyone who wants to borrow money for economic investment. Investment can change rapidly in response to changes in interest rates and the total output. There is direct relationship between profitability and financial sustainability of MFIs, the degree of relationship is strong. Profitability determines the level of financial sustainability among MFIs.

5.4 Limitations of the Study

Since the study was dealing with confidential financial information of MFIs, cooperation to give the required information had been anticipated as one of the challenges since majority of the respondents were not sure how the information would be utilized. To counter this, the researcher assured the respondents that the information provided was of strict confidence and was to be used for the purpose that was indicated.

The study was directed by two variables, this denied the study to cover a broad perspective and explore further on impact of interest rates on financial sustainability of MFIs, the study suggested further research to be conducted on the impact of interest rates on financial sustainability of MFIs.

5.5 Study Recommendations

The government should come up with better interest rates policies that will make MFIs more financial sustainable. Interest rates policies that are detrimental towards MFIs

financial sustainability should be abolished. Interest rates policies in place should make the cost of borrowing loans from MFIs more affordable to most borrowers.

Microfinance institutions should be able to meet its operational cost to be sustainable. MFI should be able to recruit, induct, train and maintain well-qualified staff who are capable of delivering the services as required. Microfinance should be an effective methodology for alleviation of poverty among the disadvantaged sections MFIs should be able to meet Market sustainability so as to achieve financial sustainability. The government should make should promote profitable MFIs which provide funds to the poor through lowering interest rates which should enable MFIs give loans to the poor population.

5.6 Suggestion for Further Research

Research can be conducted further on the impact of interest rates on financial sustainability of MFIs to identify more factors that determine the financial sustainability of MFIs. Further research should be conducted on policy framework that continue to affect sustainability of MFIs, the study should recommend how the government can change policies which should make MFIs more sustainable. The study narrowed on impact of interest rates on financial sustainability of MFIs, further research should be conducted to incorporate other financial institutions.

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APPENDICES

APPENDIX A: QUESTIONNAIRE

Please tick in the appropriate box and where applicable answer in the space provided

PART ONE

Background information

Tick as appropriate

INSTITUTIONAL DATA

1. For how long has your MFI been operating?

5 years and below [1]

6-10 years[2]

11-20 years [3]

20 years and above [4]

2. What services do you offer? {Tick if all applicable}

Credit provision [1]

Savings [2]

Consultation/Advisory [3] Others Specify [4]

3. Gender:

Male (1)

☐

Female (2)

☐

4. Indicate age bracket:

- ☐ 18-30 yrs(1)
- ☐ 31-40 yrs (2)
- ☐ 41-50 yrs (3)
- ☐ Above 51 yrs (4)

5. Highest Education Level

- ☐ Primary level (1)
- ☐ Secondary level (2)
- ☐ College level (3)
- ☐ University level (4)

Any other please specify.....

PART TWO: INTEREST RATES

6. Interest rates determines financial sustainability of your institution

- ☐ Yes
- ☐ No
- ☐ Don't know

7. Interest rates are high on loans

- ☐ Yes
- ☐ No

☐ Don't know

8. Interest rates affect income of MFIs?

☐ Yes

☐ No

☐ Don't know

9. There are policies in place against interest rates ceilings

☐ Yes

☐ No

☐ Don't know

PART 3: FINANCIAL SUSTAINABILITY

10. The institution generate enough revenue

☐ Yes

☐ No

☐ Don't know

11. Does your institution provide loan to the poor?

☐ Yes

☐ No

☐ Don't know

12. Does your organization have clear governance structures?

☐ Yes

- ☐ No
- ☐ Don't know

PART FOUR: COST

13. Is your organization able to meet its operational cost?

- ☐ Yes
- ☐ No
- ☐ Don't know

14. The cost of borrowing loans is high

- ☐ Yes
- ☐ No
- ☐ Don't know

PART TWO: PROFITABILITY

15. The organization is profitable organization profitable

- ☐ Yes
- ☐ No
- ☐ Don't know

16. The organization has diversified sources of income?

- ☐ Yes
- ☐ No
- ☐ Don't know

17. Profitability is affected by changes in Interest rates

- ☐ Yes
- ☐ No
- ☐ Don't know