THE EFFECT OF LENDING BY MICROFINANCE INSTITUTIONS ON THE FINANCIAL PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES IN NAIROBI COUNTY, KENYA

BY

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DECLARATION

This 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 Examination with my approval as University Supervisor.

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DEDICATION

This research project is dedicated to my beloved wife Rachel and lovely Son; Henry Dick for their presence, moral support and endurance with me during my project writing period and entire duration during my Master's Degree programme.

TABLE OF CONTENTS

DECLARATION ... II

DEDICATION ... III

ACKNOWLEGEMENTS ... IV

LIST OF TABLES ... VII

LIST OF FIGURES ... VIII

LIST OF ABBREVIATIONS ... IX

ABSTRACT ... 1

CHAPTER ONE ... 3

INTRODUCTION ... 3

1.1 Background of the Study ... 3
1.1.1 Lending by Microfinance Institutions ... 5
1.1.2 Growth and Development of SME ... 5
1.1.3 Effect of Lending by MFIs on Growth and Development of SMEs ... 6
1.1.4 SMEs in Nairobi County ... 7
1.2 Research Problem ... 7
1.3 Objective of the Study ... 9
1.4 Value of the Study ... 9

CHAPTER TWO ... 10

LITERATURE REVIEW ... 10

2.1 Introduction ... 10
2.2 Theoretical Review ... 10
2.2.1 Neo-Classical Theory ... 10
2.2.2 Joint Liability Theory ... 11
2.2.3 Women `s Empowerment Theory ... 12
2.3 Determinants of Growth of SMEs ... 12
2.4 Empirical Review ... 14
2.5 Summary of Literature Review ... 18

CHAPTER THREE ... 19

RESEARCH METHODOLOGY ... 19

3.1 Introduction ... 19
3.2 Research Design ... 19
3.3 Population ... 19
3.5 Data Collection ... 20
3.6 Data Analysis ... 21
3.6.1 Analytical Model ... 20

3.6.2 Test of Significance……………………………………………………….……21

CHAPTER FOUR...23

DATA ANALYSIS, RESULTS AND DISCUSSION..23

4.1. Introduction...23
4.2 Descriptive Statistics...23
4.3 General Information...24
4.4 Type of Business, Credit Accessibility and Challenges facing the SMES 26
4.5 Regression Analysis...29
4.6 Interpretation of Findings...33

CHAPTER FIVE 34

SUMMARY, CONCLUSION AND RECOMMENDATIONS 34

5.1 Introduction...34
5.2 Summary 34
5.3 Conclusion...35
5.4 Recommendations for Policy 36
5.5 Limitations of the Study...36
5.6 Areas for Further Research 37

REFERENCES...38

APPENDICES...42

APPENDIX I: INTRODUCTION LETTER...42
APPENDIX II: QUESTIONNAIRE FOR SMEs...43

LIST OF TABLES

Table 4:1: Response Rate..23
Table 4.2: Duration of Time Business has been in Operation 26
Table 4.3 Category of SME 26
Table 4.4 Type of business 27
Table 4.5 Source of Capital for the SMEs 27
Table 4.6 Challenges Faced by SMEs Accessing Loans from the MFIs ……………...28
Table 4.7 Extent of Statement on Growth and Development 29
Table 4.8: Model Summary 30
Table 4.9: ANOVA...31
Table 4.10: Coefficient of Determination..31

LIST OF FIGURES

Figure 4.1 Respondents Gender 24

Figure 4.2: Academic Qualification.. 25

LIST OF ABBREVIATIONS

AMFI -	Association of Microfinance Institutions of Kenya
BB -	Branchless Banking
CBK -	The Central Bank of Kenya
CRBs -	Credit Reference Bureaus
DTMs -	Deposit Taking Micro Finance Institutions
ERS -	Economic Recovery Strategy
FSAs -	Financial Services Associations
GDP -	Gross Domestic Product
GNI -	Gross National Income
GOK -	Government of Kenya
IGAs -	Income Generating Activities
IFRS -	International Financial Reporting Standards
KFSD -	Kenya Financial Sector Deepening
KCB -	Kenya Commercial Bank
K-REP-	Kenya Rural Enterprise Program
KWFT-	Kenya Women Finance Trust
MFIs -	Micro Finance Institutions
MIS -	Management Information Trust
NBFIs-	Non Banking Financial Institutions
NGOs -	Non Governmental Organizations
SMEs -	Small and Medium Enterprises
UNDP-	United Nations Development Programme
UWFT-	Uganda Women Finance Trust
WB -	World Bank

ABSTRACT

The provision of financial services, especially credit and saving facilities plays an important role in the development of the economy. With the efforts of microfinance institutions taking their services within the reach of poor and small medium enterprises that have not benefited from the conventional formal financial system, growth and expansion of SMEs has been observed.

The main objective of this study was to investigate the effect of lending by microfinance institutions on the financial performance of small and medium enterprises in Nairobi County, Kenya**.** The study adopted a descriptive survey research design and the target population for the study was 120 SMEs that have operated for five years and above. The target population was stratified into homogeneous categories as wholesalers, retailers, restaurants, cosmetics and service delivery. A sample of 120 SMEs was drawn proportionately and randomly from the strata. Data was collected via a semi-structured questionnaire whose validity and reliability was established in the pilot test. Quantitative data analysis was undertaken to generate both descriptive and inferential statistics, this was done using statistical package for social sciences (SPSS). Presentation of data was done in frequency tables and figures and the interpretation made based on the research objective.

The study found that the main source of capital for the SMEs was from microfinance institutions, from personal savings and partnership. The study further revealed that the amount of loans borrowed by the SMEs from MFIs is significantly and positively related to the financial performance of the small and medium enterprises. The study findings show that not all SMEs operating within Nairobi County are able to access loans facilities from the available MFIs, this is due to the following challenges stringent repayment terms, long time taken processing the loan, and difficulty raising the collateral hence opting for cheaper sources of capital. It is on this basis that the SMEs which have operated for more than five years were considered for this study because they are able to meet all these collaterals. 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 Return on Assets and accessibility of credit in MFI and also a

positive one between Return on Assets and the number of years the small and medium enterprise has been in operation.

The study recommends that access to finance should be identified as a freedom to growth of SMEs, training is crucial for productivity and quality as well as it influences the effectiveness, efficiency and motivation of the employees. The study recommends that strong evidence that access to financial services and the resultant transfer of financial resources to poor women, over time, lead to women becoming more confident and assertive. The study also recommends good management of SMEs as one of the factors affecting their growth and development. Further the amount of loans given by MFIs to SMEs should be increased to enable the SMEs grow to bigger companies.

CHAPTER ONE
INTRODUCTION

1.1 Background of the Study

Microfinance according to Otero (1999) is "the provision of financial services to low-income poor 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) 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 access 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 1970s 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. The 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 (1989) states that "microcredit refers to small loans, whereas microfinance is appropriate where NGOs and MFIs 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 defaulters, high lose and 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 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 clear for the first time that microcredit could provide large-scale outreach profitability.

The 1990s “saw accelerated growth in the number of microfinance institutions created and an increased emphasis on reaching scale”(Robinson, 2001). Ditcher (1999) 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 Lending by Microfinance Institutions

Microfinance institutions provide 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 institutions 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 banking services. Microfinance institutions provide a comprehensive range of financial services to the "unbanked people" working in informal sectors which best fits their needs and affordability.

The MFIs subsequently provides different services to a client, most commonly in the form of a loan. These services lead to the client modifying his/her 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 within the savings of the member (Schmidt, 1997).

1.1.2 Growth and Development of SMEs

SMEs play a key 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. The small and medium enterprises, 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 country's businesses. In South Africa, it is estimated that 91% of the formal business entities are SMEs (Quarterly 2010).

The contribution made by SMEs does very widely between countries and regions. Nevertheless, although they play 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 innovations in economies, partly through collaboration with the larger corporate sector. As noted, SMEs tend to be more labor intensive and at 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 attributed 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 (Stewat, 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 Effect of Lending by MFIs on Growth and Development of SMEs

Lack of access to finance has been identified as one major constraint to growth of SMEs (Owualah, 1999; Carpenter, 2001; Anyawu, 2003; Lawson, 2007). The extent to which SMEs could access fund is the extent to which the SMEs can save and accumulate own capital for further investment (Hossain, 1988). However, SMEs find it difficult to access formal financial institutions such as commercial banks for credit.

The inability of the SMEs to meet the standard of the formal financial institutions for loan consideration provides a platform for the informal institutions to attempt to fill the gap usually based on informal social networks, and this is what has led to the emergence of MFIs as an alternative source of funding to the SMEs.

The provision of financial services, especially credit and savings facilities play an important role in the development of the economy. With the efforts of MFIs to take microfinance services within the reach of poor people and SMEs that have not benefitted from the conventional formal financial system, growth and expansion of the SMEs sector will be revealed after this study whether there is a sign of growth and expansion or not.

1.1.4 SMEs in Nairobi County

Nairobi County is the capital city of Kenya and is both a commercial and political hub in the region. The county is home to thousands of Kenyan businesses and over 100 major international companies and organizations, including the United Nations Environment Programme (UNEP) headquarter. Also found in Nairobi is the Nairobi Securities Exchange (NSE) which is one of the oldest and best performing in the continent. It is Africa's fourth largest exchange in terms of trading volume, capable of making 10 million trades a day.

By virtue of its level of development and opportunities, the county is home to a number of the Small and Medium Enterprises in the country which also constitute the largest component of the informal sector. The sector generates 84.3 per cent of the new jobs annually (Economic Survey GoK 2014).

1.2 Research Problem

The major barrier to the development of Small and Medium Enterprises is access to credit. These enterprises differ in the level in which they are and the products and services offered to them by the MFIs. The small and medium enterprises need to be financed differently and the financing is determined by whether the firm is in the start-up phase or existing one and also whether it is stable, unstable, or growing. Stable survivors are those who benefit in having access to the financial services provided by MFIs. Unstable survivors are groups that are considered not credit worthy for financial services to be provided in a sustainable way and growth enterprise are small and medium enterprises with high possibility to grow.

The provision of financial services, especially credit and saving facilities plays an important role in the development of the economy. Despite the efforts of microfinance institutions to take the conventional formal financial system, growth and expansion of SMEs sector had not shown any sign of growth and development (Kenya Economic Survey, 2009). The Government of Kenya has put several measures to assist in the development of the economy. Such measures include devolved funds (e.g. CDF, UWEZO Fund, Women Enterprise Fund, Youth Enterprise Development Fund, Revolving Loan Fund, LATF, Community Development Trust Fund among others), the implementation of the Free Primary Education, Free Subsidized Secondary Education, the expansion of the social protection initiatives (Cash Transfers (CT) for the elderly, CT-Orphans and Vulnerable Children (OVC) and CT-Persons with Disabilities), including others. On financial matters, the government has adopted a new way of computing the Consumer Price Index (CPI), cushioning the index from external shocks, while the Monetary Policy Committee (MPC), on a monthly basis, has been setting the Central Bank Rate (CBR) and which as acted as the base lending rate for commercial banks. Consistently, the Central Bank of Kenya (CBK), while implementing its mandate, has been mopping extra currency in the market to stabilize both exchange and interest rates.

Coase (1960) pointed out that financial intermediation involves transactions costs and according to Chijoriga and Cassimon (1990) transaction costs comprises cost involved in finding a lender, mismatch costs and risk premium, all transactions increases the gross cost of credit for the borrower. The conceptual framework reflects the effect of transaction cost on SMEs when accessing and servicing MFI services. High transaction cost limit SMEs effective utilization of the services received hence limit SMEs growth and development.

Although the Microfinance Act 2006 stipulates the operations of MFIs in Kenya, many SMEs have not accessed lending and those that have acquired loans from MFIs find it expensive to pay. Further, studies on the impact of MFIs have yielded mixed results. It is worth noting that Kenya has adopted a devolved system of government and each level has its own mandate as stipulated in the constitution. Taking into consideration this new government structure, no study has investigated the effect of lending by MFIs on the growth and development of SMEs in Nairobi County. This study, therefore, is an initial step in that direction and investigated whether capital loans and services offered by the MFIs to Small and Medium Enterprises lead to the growth and development of the organizations (SMEs).

This study seeks to answer the following question: What is the effect of lending by Microfinance Institutions on the growth and development of Small and Medium Enterprises in Nairobi County?

1.3 Objective of the Study

To investigate the effect of lending by MFIs on the financial performance of SMEs in Nairobi County.

1.4 Value of the Study

This study provided a better understanding to microfinance programs and how they can contribute to the growth of SMEs. The Government may benefit from the findings of this study by bringing into light various policies and regulations to enact in order to help in the growth of SMEs in Kenya and address these factors according to the study recommendations.

The academicians found this study helpful as it added knowledge in finance especially on SMEs and MFIs structures. It was also useful for further discussion and research for more exploration and further develops their studies. The investors also fond this study very important as they were in position to exploit the available opportunities within the SMEs sector and the General Public was more enlightened on the role MFIs play in economic development of SMEs

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

The chapter focuses on the concepts of microfinance and the role they play in the growth and development of SMEs. It highlights Concepts, Ideas, Theories and Opinions from Authors/Experts, theoretical perspectives. It also describes related studies. The data is secondary which is obtained from text books, journals and internet.

2.2 Theoretical Review

This section highlights theoretical reviews of microfinance lending on financial performance of SMEs and this will be on the Neo-Classical Theory, Joint Liability Theory and Women Empowerment Theory.

2.2.1 Neo-Classical Theory

Neo-classical growth models emphasize the importance of savings in order for a country`s economy to grow. For any given capital stock the production function determines how much output the economy produces. The capital stock changes overtime and those changes may lead to economic growth. Investment and depreciation affect the capital stock and there is one single capital stock at which the amount of investment equals to the amount of depreciation; the steady state level of capital. The steady state level of capital is the long run equilibrium in an economy. The saving rate in an economy determines the allocation of output between consumption and investment and is thus a key determinant of the steady state capital stock; if the savings rate is high the economy will have a large capital of stock and a high level of output. (Lipsey et al., 1999).

One of the main constraints for poor households in developing countries is the lack of access to financial services. This is a consequence of poorly developed financial markets and commercial banks tending to offer its services almost exclusively to the medium and large companies that are thought to be credit worthy. (Todaro et al., 2003). This implies a major consumption and savings constraint for the individuals living in developing countries and in view of neo-classical growth theories, it implies that the accumulation of capital is hampered and the growth of the country`s economy is restrained. (Lipsey et al., 1999).

The borrowing constraint makes it impossible for the individuals to smooth on the consumption and to follow the optimal consumption pattern. The individuals find themselves in a corner solution where the desired level of consumption at each point of their life cannot be reached. The restriction of the possibilities to invest and consume makes it harder to obtain basic services such as food, education, health care and housing. In order to reduce the borrowing constraint, individuals that wish to obtain credits but who do not have access to the formal financial market are often forced to borrow from lenders in the informal markets who charge high interest rate, which in some cases reaches up to 20 percent a day. (Todaro et al., 2003)

The emergence of microfinance institutions represents an option to going to informal moneylenders and presents a way to eliminate the borrowing constraint in developing countries. In countries where the financial system is not well developed and functioning, microfinance can lead to an increase in the individual`s utility and wealth by enabling him or her to increase consumption and savings. It allows the individual to save which make it possible for each individual to smooth consumption and follow his or her optimal lifetime consumption. (Todaro et al., 2003, Bayoumi, 1993).

2.2.2 Joint Liability Theory

Joint liability as a theory can be interpreted in several ways that can broadly be grouped under two categories. First, under explicit joint liability, which can occur when one borrower cannot repay a loan, Group members are contractually required to repay in the member`s stead. Such repayments can be enforced through the threat of common punishment, typically the denial of future credit to all members of the defaulting group, or by drawing on a group savings fund that serves as collateral (Banerjee et al., 1994).

The Second category of the concept of joint liability is implicit, which is to say that, a believe among the borrowers that, if a group member defaults, the whole group will become ineligible for future loans even if the lending contract does not specify this punishment. One form in which this can happen is if the microfinance organization itself chooses to fold its operations when faced with delinquency.

2.2.3 Women `s Empowerment Theory

Generally, societies with high level of gender inequality are characterized by slow economic growth and high level of poverty, (King et al, .2001). Studies have shown that well performing microfinance programs, specifically the ones providing programs integrated with social services, empower and increase the wealth of the borrower. This is one of the reasons of microfinance institutions to focus on women. This is also one of the reasons of why international donors, local NGOs and governments have put microfinance on both their gender and poverty reduction agenda. (Cheston et al., 2002).

Empowerment is a concept used in variety of academic fields; sociology, economics, anthropology and public health. Despite that, the definition of the word is surprisingly alike in all the disciplines. The women`s possibility to make decisions concerning themselves, their children and their families is one important aspect often underlined; the control over one`s own life as well as the control over economic resources is the other. Access to financial resources is pointed out as central factor that contribute to the empowerment of women. The concept of empowerment can be divided into various dimensions and when looking into the economic and interpersonal dimension, that is women`s control over income, access to credit, decision making in the household and birth control are emphasized. (Malhotra et al., 2002).

Todaro et al., (2003) states that women often bear the heaviest part of poverty, with no education, no jobs and no income in the formal sector and limited social mobility. If the women could achieve a better education, health and economic wellbeing, their status would improve in both the family and in the society. Todaro et al., 2003 makes the connection between empowerment of women and lower population growth. In many countries, the women have a low status, no control of power over their own body, which result in no birth control and high fertility rates.

2.3 Determinants of Growth of 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 globalized 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.

Financial support is also a determinant of growth for the SMEs. According to Guffey, business plan is essential when you start your own business. Unless you can count on the bank of your relatives you will need financial backing such as a bank loan or venture capital supplied by investors. Throughout the region, SMEs do not have an easy access to credit and equity finance. This is because of the weak banking institutions in the region, the absence of capital markets, and the weak legal framework for credit and collateral.

A firm's growth is dependent on the managerial knowledge (Macpherson & Holt, 2007). Training is crucial for productivity and quality as well as it influences the effectiveness, efficiency and motivation of the employees (Thassanabanjong et al., 2009). The SME owner has considerable personal influence over a firm's strategies, tactics and operations to engage in decision process across the firm. As a result, although a flat, informal organizational structure is likely to exist, decisions making tends to be quite centralized around the owner. The entrepreneurs' personality and behavior are to be casual factors for or against growth-oriented achievement. It is characteristics of small business that power decisions are centralized at the level of owner-manager so his or her personality, skills, responsibilities, attitude and behavior will have influence on business strategy (Levy and Powel, 2005)

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, a part from the traditional determinants of age and size.

2.4 Empirical Review

In 1999, Morduch wrote a paper entitled “The Microfinance Promise”. He writes that, ’in many poor countries, the people put much hope into the new financial sector that is going to change the economic and social structure by providing microcredit’. Morduch writes that there are about 8 to 10 million households in the world that are members in microfinance programs. In his paper, Morduch reviews earlier studies about different kinds of MFIs concerning structure, financial sustainability, repayment rates, outreach, collaterals etc. Morduch finds that very few impact studies have been made with trustworthy treatment and control groups and he stresses the importance of better research on the object.

Today, MFI’s lending to groups has group sizes with between 5 to 50 members. Abbink et al., 2002 have investigated the importance of group sizes for the repayment performance, with the help of a game theoretical model. Their findings suggest that both smaller and larger groups have good repayment performance. Large groups have slightly less solidarity than smaller groups but this is compensated by a large distribution of risk. (Abbink et al., 2002).

Carpenter and Peterson (2002) argue that firms whose financial needs exceed their internal resources may be constrained to pursue potential opportunities for growth. The insufficient internally generated liquidity is therefore one of the factors which are frequently cited as the causes of Small and Medium failure in developing economies. It is from this perspective, the Microfinance Institutions are considered to be an appropriate solution to the small and medium enterprises in availing the loans.

Empirical evidence shows that all improvements of the women's status will contribute to breaking the vicious cycle of poverty and insufficient schooling. An employment outside their homes, which reduces their isolation and an independent source of income are aspects that would improve their roles. Here, microcredit can play a crucial role. (Todaro et al., 2003)

There is strong evidence that access to financial services and the resultant transfer of financial resources to poor women, over time, lead to women becoming more confident and assertive. Access to finance enables poor women to become economic agents of change by increasing their income and productivity, access to markets and information, and decision- making power. This empowerment is very real, and can take different forms:

However, it would be wrong to assume access to financial services automatically has a positive impact on women's welfare. In some instances, women's access to microfinance may result in increased violence within the household, leaving them with a greater loss of power. Women borrowing for a microenterprise may end up being forced to work longer hours and lose control over financial resources and decision making to male members of the family. Neither should microfinance be seen as a substitute for dealing with key structural issues pertinent to women and poverty, such as lack of skills and education, or legislation that discriminates about women (e.g., property rights, agrarian or land reform, trade agreements)

Khandler (2003) has made a quantitative research paper on the World Bank. The objective of the study was to see the long run effects of microfinance on household consumptions and poverty in Bangladesh. Khandler used household data that was collected firstly during 1991-1992 and secondly during 1998-1999. He chose Bangladesh since it is the country where there is the largest microfinance operation in the world. To estimate the programs effect, Khandler uses panel data at household level. In 1991/2 the World Bank surveyed 1769 households from 87 villages that were randomly chosen. They surveyed households within three different microcredit banks; BRAC (Bangladesh Rural Advancement Committee), Grameen Bank and BRDB`s (Bangladesh Development Board) RD-12 project and households that were not participants in any program. The villages that were randomly chosen had been within the project for atleast three years and the survey was made during three different seasons. The same households were used for the follow-up survey made in 1998/99. During this survey some new households were included and the sample of households reached 2599, (Khandler, 2012).

The result that Khandler found was that the aggregate moderate poverty had declined from 83% in 1991/92 to 66% in 1998/99, which means a reduction of 17 percentage points over seven years. The program participant`s poverty reduced with 20 percent whereas the poverty for the non-participants reduced with 15 percent. He finds that the microfinance program particularly has an impact on the consumption on non-food products. Thanks to the growth of local economy, even the non-participants take advantage of the microfinance programs. Even though the programs reduce the extreme poverty, there is not such a big reduction in aggregate poverty, which means that the microfinance may not be the instrument to solve the poverty problem of Bangladesh as a country. Khandler does believe in microfinance as an instrument in poverty reduction for Bangladesh, but to reach the national level, the microfinance sector may need to improve the financial services. They need to improve the skills of the poor borrowers and educate them in marketing and management in order to improve their productivity and income. He concludes that microfinance only is one of many instruments in order to reduce the poverty and adds that the most important aspects are growth and investment in human capital.

High repayment rates are obtained which leads to the granting of new loans for several periods. The findings show that self-selected groups have slightly higher willingness to repay. In situations where the members of the group are able to verify the outcome of the economic activities of the other members and punish them if they cheat, incentives to cooperate are proven to be stronger. According to Walid Seddiki et al., group lending out-performance individual lending in the view of risk reduction for the MFI'Littlefield et al. (2003) have written a report to see whether microfinance is an effective strategy to reach the millennium development goals or not. They start their paper by declaring that even though there would be a great progress within microcredit, the area of the millennium development goals are in need of their aspects as well, such as functioning government, physical security, economic growth, security and basic transportation. They continue and state that the microcredit allow poor people to plan for their future and to put their children to school for longer periods.

In order to graduate from poverty, Littlefield et al. examines three areas that are of great importance. First of all, there is a need of promoting children`s education. They mean that children of the microfinance clients are more likely to go to school and stay longer. The next aspect is the improvement of the health of children and women.

They claim that the main reason for microcredit clients not to repay their loans is illness and the expenditure that come with it. They continue and prove that households that are members in microfinance institutions appear to have better nutrition and health practices if one compare with non-clients. The third and final aspect is the empowering of women. It has been shown that women are more likely to invest their income in their family`s wellbeing than men. Littlefield et al believes that giving credits to women will result in that women get more access to money, which will empower them to become more confident, taking more decisions in the family and in the society and confront gender inequalities. Littlefield et al, conclude: "Access to financial services forms a fundamental basis on which many of other essential interventions depend".

Muthoki (2012) have tested the hypothesis of group borrowers and joint liability in an experiment using a game theoretical model with a limited amount of loan periods. Game theory suggests that each player will repay nothing in the last loan period, since there is no incentive to repay. But since there is a sub-game equilibrium, no one will repay anything in the round before the last round, neither in the round before that and so on. The game will therefore end after the first loan period. The authors found that even though game theory recommends each player to free ride, the solidarity and the cooperation is high in all scenarios.

Todaro et al., 2012 tells that there are evidences that prove that better education of the mother lead to a better health of her children. A good health, a better and longer education lead to higher future income and utility according to the human capital theory.

Increased incomes, savings and education loan products provide poor people with the ability to invest in their children's future, particularly in their education. Empirical evidence indicates that, in poor households with access to financial services, children are not only sent to school in larger numbers, but they also stay in school longer. Even where children help out in family enterprises, the poverty-induced imperative of child labour decreases and school drop-out rates are much lower in client households than in non-client households. Studies on the impact of microfinance on children's schooling show that:

In Bangladesh, almost all girls in Grameen client households had some schooling, compared to 60% of girls in non-client households. The schooling rate for boys was significantly higher-81% of boys in client households received some schooling, compared to 54% in non-client households.

2.5 Summary of Literature Review

Review of literature on the financial performance of SMEs indicate that many SMEs fail to expand due to limited financial resources, poor managements, use of outdated technologies, stiff competition from bigger firms, poor management of account receivables, unfavorable government policies among others. According Yaron (1997) the study found that poor access to loans and limited finance as the main causes limiting the growth of SMEs. Carpenter and Peterson (2002) argue that firms whose needs exceed their internal resources may be constrained to pursue potential opportunities for growth. The insufficient internally generated liquidity is therefore one of the factors which are frequently cited as the causes of SMEs failure in developing economies.

The review of literature shows mixed results. Some studies argue that loan size borrowed significantly and positively do contribute to the financial performance of SMEs, while other studies indicated that SMEs that accessed MFIs loans did not show any sign of growth. Due to mixed results it is worthy to investigate whether lending by MFIs has a positive effect on the financial performance of SMEs in Nairobi County, Kenya.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

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

3.2 Research Design

Research design determines the general research approach or strategy to be adopted by a study. The data used in this study was derived from investigation results of a primitively-designed questionnaire. The questionnaire is divided into two parts. The first collects information from the Microfinance Institutions and the other questionnaire is designed to collect information from selected Small and Medium Enterprises.

3.3 Population

Population is the aggregate of the whole of the study unit. According to Ngechu (2004), a population is a well-defined or set of people, services, elements, and events, group of things or households that are being investigated. This definition ensures that the population of interest is homogeneous.

The target population under the study were registered SMEs in Nairobi County. A total of 3060 SMEs are registered with the Nairobi City County. However for the purpose of this study only SMEs that had operated for five years and above were considered to form the target population since it was assumed that this length of time could provide meaningful measures of performance. This reduced the number of SMEs to 120. Data for the year 2009 to 2013 from SMEs was used for the purposes of this study.

3.4 Sample Design

The study used probability sampling techniques to create a sampling frame for SMEs. Stratified random sampling technique was used to select a total of 120 SMEs that constituted the sample size. For homogeneous groups, 10% of the sample was considered as representative (Mugenda & Mugenda, 2004). Stratified random sampling helped 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 was obtained by treating each stratum as a sample on its own right. Once the population was stratified in a meaningful way, a sample of members from each stratum was drawn using a symmetric sampling procedure. For example the study was categorized of 60 stratums for Small enterprises and60 for Medium enterprises which give the total sample of 120.

3.5 Data Collection

Every research work has a framework for collecting data. Its function is to ensure that the required data is collected accurately and economically. In this proposed study, both primary and secondary data was used for the study. The tool for data collection for primary data was the questionnaire to collect the required data. A questionnaire is a data collection instrument that sets out in a formal way the questions designed to elicit the desired information. The questionnaire was developed in line with the study objective and was pre-tested for validity and reliability on a small population. The questionnaire was organized in to sections. Section A collected the background information from the respondents and section B collected the information on the effects of lending by MFIs on the growth and development of the SMEs and other factors that affect the growth and development of SMEs in Nairobi County. Secondary data was gathered through analysis of literature on trends and effects of lending by MFIs on the growth and development of SMEs in Nairobi County, Kenya and even the Country at large.

3.5.1 Data Validity and Reliability

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

To make sure that the validity and reliability of the questionnaire to be used in the research work , the 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

Both quantitative and qualitative approaches were applied to process and analyze the data. Quantitative analysis began with the listing and coding open-ended data, which together with pre-coded quantitative data was digitalized using the Statistical Package for Social Sciences (SPSS) and STATA. The data was cleaned, verified and run using both SPSS and STATA to generate descriptive statistics, cross-tabulations and significance tests. In the qualitative dimension, data was listed and organized under various thematic areas based on the research objectives and questions. The analyzed results were presented using tabulations, charts and graphs. The next stage was involving description of qualitative data, analysis of thematic areas and interpretation of the data, which was then, be integrated with quantitative output to form the reporting framework. A regression model was fitted to show the relationship between the effects of MFI lending and the financial performance of SMEs.

3.6.1 Analytical Model

The study used simple regression model because it is easier to adjust independent variables as it allows to explicitly controlling many other factors that could simultaneously affect the independent variable. In addition, the regression model can match fairly general functional form relationships.

The formulated Regression Equation follows:

$$Y_I = B_0 + B_1 X_1 + B_2 X_2 + B_3 X_3 + B_4 X_4 + \varepsilon$$

Where;

Y_I= Profitability of SMEs as measured by Return on Assets

X_1=The Accessibility of credit by SMEs from MFIs

X_2= The SMEs type of business for analysis, Wholesalers, Retailers, Restaurants, Cosmetics and Service Delivery

X_3=Number of years the SMEs has been in business

X_4= The Composition of the SMEs for analysis, Sole Proprietorship and Partnership

B_0 = is the intercept (Value of Y when all other variables take the value of zero)

B_i= is the Coefficient of independent variables

ε = is the error term.

To establish the effect of lending by microfinance institutions to the growth and development of small and medium enterprises in Nairobi County, the formulated Regression Equation above was used where Return on Assets was shown as follows;

ROA=B_0 + B_1 (Accessibility of credit by SMEs from MFIs) + B_2 (Type of business of the SMEs) +B_3 (Number of years the SMEs has been in business) + B_4 (Composition of SMEs) +ε.

The independent variables X_1, X_2, X_3 and X_4 are variables of the Microfinance Institution used for this study which was measured using the various questions asked the respondents in the questionnaire. The change in value of Bo would be the degree of effect on financial performance of SME and the positive and negative sign of the value show the direction of effects.

3.6.2 Test of Significance

The statistical test of significance was performed at 95% confidence level. Test of significance was established and the coefficient of determination (R^2) was used to predict the effect of 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 presents the analysis of data and discussion of the research findings. The chapter outlines the findings based on the research objectives. The study sought to establish the effect of lending by microfinance institutions on the financial performance of small and medium enterprises in Nairobi County, Kenya. SPSS was used to generate the descriptive statistics and to establish the relation between the dependent and the independent variables of the study.

4.2 Descriptive Statistics

4.2.1 Response Rate

The study targeted to sample 120 respondents in collecting data with regard to effect of lending by microfinance institutions on the financial performance of small and medium enterprises in Nairobi County. From the study, 85 out of 120 sampled respondents filled in and returned the questionnaire contributing to 71%. This commendable response rate was made a reality after the researcher made personal visits to remind the respondent to fill-in and return the questionnaires.

Table 4:1: Response Rate

Response	**Frequency**	**Percentage**
Responded	85	71
Not responded	35	29
Total	**120**	**100**

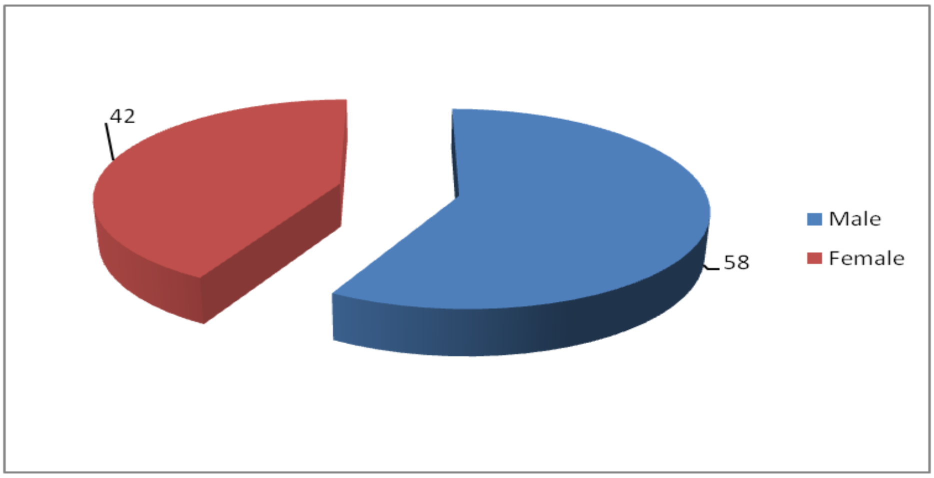
Source: Research Findings

4.3 General Information

4.3.1 Gender of the Respondents

According to the findings in Table 4.1 on the gender of respondents, the majority of respondents as indicated by 58% were males, while females were shown by 42%. This study shows that there were more males than females working in microfinance institutions and in small and medium enterprises in Nairobi County

Figure 1: Respondents Gender



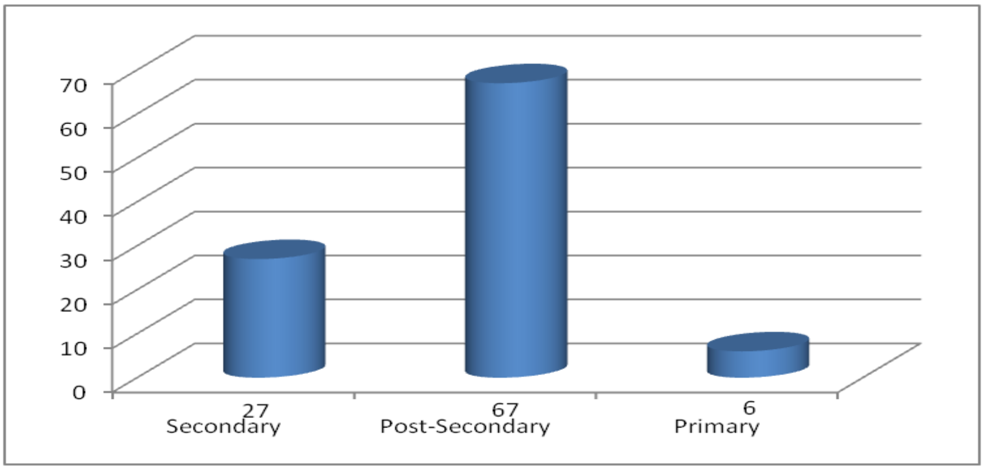
Source: Research Findings

4.3.2 Level of Education

Table 4.2 shows the study findings on the academic qualification of the respondents. Majority of the employees at 67% had post-Secondary level of education, 27% had secondary level of education, while 6% of the total respondents indicated to have primary level of education.

This implied that most of the staff members had attained a higher level (post-Secondary) of academic qualification and thus had acquired recommendable qualifications to work effectively in the SMEs and MFI's in Kenya. This finding is as observed by Katz (1992) that those with higher education are more successful as they have more knowledge and have modern managerial skills making them more conscious of the reality of the business work.

Figure 2: Academic Qualification



Source: Research Findings

4.3.3 Duration of SMEs Operation

The researcher was also interested in knowing duration the SME had been in operation, which was analyzed as shown in the table 4.2. The majority 60% of the respondents indicated their SME had been in operation for 5 to 10years, 28% of the respondents indicated their SME had been in operation for 1 to 5 years, 12% indicated that their SME had been in operation for a period of above 10 years. This indicates that the majority of the respondents of this study had worked for an ample time thus they were conversant with the information that the study sought pertaining to the businesses. According to Holman, Joyeux and Kask (2008), working duration is associated with greater output, in a given industry. The productivity outcome of hours is rarely observable directly.

Table 4.2: Duration of Time Business has been in Operation

	Frequency	**Percent**
1-5 Years	24	28
5-10 Years	51	60
Above 10 Years	10	12
Total	**85**	**100**

Source: Research Findings

4.3.4 Category of SME's

The respondents were requested to indicate the category under which their SME falls in. From the majority respondents 66% indicated their SME was a partnership, and 34% indicated their SME was a sole proprietorship.

Table 4.3 Category of SME

Response	**Frequency**	**Percent**
Partnership	56	66
Sole Proprietorship	29	34
Total	**85**	**100**

Source: Research Findings

4.4 Type of Business, Credit Accessibility and Challenges the SMES face in Getting Loans and other Services from the MFIs

4.4.1 Type of business

The study sought to find out the type of business the SME engages in. From the study findings the majority of the respondents 31% indicated that their business engages in wholesales, 26% indicated their business runs as a retailer, while 19% of the respondents indicated their business engages in restaurant and service delivery respectively, other 6% indicated that their business engages in cosmetics. This is depicted in the table below.

Table 4.4 Type of business

Statement	**Frequency**	**Percent**
Wholesalers	26	31
Retailers	22	26
Restaurants	16	19
Cosmetics	5	6
Service Delivery	16	19
Total	**85**	**100**

Source: Research Findings

4.4.2 Source of Capital for the Business (SMEs)

The study sought to establish the source of capital for the business (SMEs). The majority of the respondents 47% strongly agreed that the source of capital was from microfinance institutions, other 21% strongly agreed the source of capital was from personal savings and partnership respectively while11 % strongly disagreed that their source of capital was from the family.

Table 4.5 Source of Capital for the SMEs

Statement	**Frequency**	**Percent**
Personal Savings	18	21
Family	9	11
Microfinance institutions	40	47
Partnership	18	21
Total	**85**	**100**

Source: Research Findings

4.4.3 Challenges Faced in Accessing Loans from the MFIs

The researcher requested the respondents to indicate challenges faced by the enterprises in accessing loans from MFIs,51% of the majority respondents strongly agreed that the challenges faced are stringent repayment terms, 24% indicated long time taken processing the loan, 18% indicated difficulty raising the collateral, 8% strongly disagreed that high transaction costs as one of the challenges.

Table 4.6 Challenges Faced in Accessing Loans from the MFIs

Statement	**Frequency**	**Percent**
Long time taken processing the loan	20	24
Difficulty raising the collateral	15	18
Stringent repayment terms	43	51
High transaction costs	7	8
Total	**85**	**100**

Source: Research Findings

4.4.4 Extent of Statement on Growth and Development of Enterprises

The researcher requested the respondents to indicate the extent of statements related to growth and development of enterprises. The majority of the respondents indicated that stiff competition from bigger firms affects the growth of SMEs to a great extent as shown by a mean score of 2.5902, unfavorable government policies and regulations contribute to the growth and development of SMEs to a moderate extent as shown by a mean score of 2.6393, poor management of SMEs is one of the factors affecting their growth and development to a moderate extent as shown by a mean score of 2.7049, SMEs increase their productivity through getting funds from MFIs which leads to enterprises growth to a moderate extent as shown by a mean score of 2.7541, MFIs contribute to the increase of entrepreneurs who start new venture to a moderate extent as shown by a mean score of 2.7965, while SMEs fail to expand due to limited financial resources was to a moderate extent as shown by a mean score of 3.7705.

Table 4.7 Extent of Statement on Growth and Development

Statement	**Mean**	**Std Dev.**
i. SMEs fail to expand due to limited financial resources	3.7705	1.60177
ii. MFIs contribute to the increase of entrepreneurs who start new venture	2.7965	1.36545
iii. SMEs increase their productivity through getting funds from MFIs which leads to enterprises growth	2.7541	1.51279
iv. Poor management of SMEs is one of the factors affecting their growth and development	2.7049	1.28250
v. Unfavorable Government Policies and regulations contribute to the growth and development of SMEs	2.6393	1.43797
vi. Stiff competition from bigger firms affects the growth of SMEs	2.5902	1.41865

Source: Research Findings

4.5 Regression Analysis

In this study, simple regression model analysis was conducted to test relationship between Return on Assets (Dependent Variables) and the factors that affect the variables (Independent Variables; Accessibility of credit from MFI, SMEs type of business for analysis, Composition of the SMEs for analysis, Number of years the SMEs has been operating).

The research used statistical package for social sciences (SPSS V 21) to code, enter and compute the measurements of the multiple regressions.

Coefficient of determination explains the extent to which changes in the dependent variable can be explained by the change in the independent variables or the percentage of variation in the dependent variable (effects of MFI lending and the growth of SMEs in Nairobi County, Kenya) that is explained by all the four independent variables (Accessibility of credit from MFI, SMEs type of business for analysis, Wholesalers, Retailers, Restaurants and Service Delivery, Composition of the SMEs for analysis, Sole Proprietorship and Partnership, age of SMEs as measured by the number of years it has been operating).

4.5.1 Model Summary

Table 4.8: Model Summary

Model	**R**	**R Square**	**Adjusted R Square**	**Std. Error of the Estimate**
1	0.893	0. 7974	0.744	0.4645

Source: Research Findings

The four independent variables that were studied, explain only 79.7% of the effect of lending by microfinance institutions on the financial performance of small and medium enterprises in Nairobi County, Kenya as represented by the R^2. This therefore means that other factors not studied in this research contribute 20.1% of the effect of lending by microfinance institutions on the financial performance of small and medium enterprises in Nairobi County, Kenya. Therefore, further research should be conducted to investigate the other factors (20.1%) that affect lending by microfinance institutions on the financial performance of small and medium enterprises in Nairobi County, Kenya**.**

4.5.2 Analysis of Variance (ANOVA) Results

Table 4.9: ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	2.453	3	1.267	7.623	.0214
	Residual	9.313	82	2.327		
	Total	**11.766**	**85**			

Source: Research Findings

The significance value is 0.0214 which is less than 0.05 thus the model is statistically significance in predicting how accessibility of credit from MFI, SMEs type of business for analysis, Wholesalers, Retailers, Restaurants and Service Delivery, Composition of the SMEs for analysis, Sole Proprietorship and Partnership, age of SMEs as measured by the number of years it has been operating affect lending by microfinance institutions on the financial performance of small and medium enterprises in Nairobi County, Kenya**.**. The F critical at 5% level of significance was 3.23. Since F calculated is greater than the F critical (value = 7.623), this shows that the overall model was significant.

4.5.3 Coefficient of Determination

Table 4.10: Coefficient of Determination

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	1.142	1.335		1.615	0.359
	Accessibility of credit from MFI	0.891	0.223	0.167	4.423	.0209
	SMEs type of business	0.813	0.241	0.076	3.752	.0217

	Composition of the SMEs	0.857	0.233	0.186	3.867	.0224
	Age of SMEs	0.787	0.147	0.199	3.547	.0239

Source: Research Findings

Multiple regression analysis was conducted as to determine the relationship between effects of lending by microfinance institutions on the financial performance of small and medium enterprises in Nairobi County, Kenya and the five variables. As per the SPSS generated table above, the equation ($Y_I = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + e$) becomes: $Y_I = 1.142 + 0.891X_1 + 0.857X_2 + 0.813X_3 + 0.787X_4 + 0.765$

4.6 Interpretation of the Findings

This section attempts to provide vivid interpretation of the findings obtained relating to the objective of the study. To investigate the effect of lending by microfinance institutions on the financial performance of small and medium enterprises in Nairobi County. The regression equation above has established that taking all factors into account (Accessibility of credit, SMEs type of business, Age of SMEs, and composition of the SMEs) constant at zero, affect lending by microfinance institutions on the financial performance of small and medium enterprise 1.142. The findings presented also shows that taking all other independent variables at zero, a unit increase in accessibility of credit from MFI lead to a 0.891 effect on lending by microfinance institutions on the financial performance of small and medium enterprise a; a unit increase in SMEs type of business would lead to a 0.813 effect on lending by microfinance institutions on the financial performance of small and medium enterprise; a unit increase in composition of the SMEs would lead to a 0.857 effect on lending by microfinance institutions on the financial performance of small and medium enterprise and a unit increase in age of SMEs would lead to a 0.787 increase in effect on lending by microfinance institutions on the financial performance of small and medium enterprise . This infers that Micro finance institutions contribute most to the countries growth followed by small and medium enterprises. At 5% level of significance and 95% level of confidence, accessibility of credit from MFI had a 0.0209 level of significance; SMEs type of business showed a 0.0217 level of significance; composition of the SMEs showed a 0.0224 level of significance; while age of SMEs showed a 0.0239 level of significance hence the most significant factor.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter provides the summary of the findings, discussion on the findings of the research, and also it gives the conclusions and recommendations on the effect of lending by microfinance institutions on the financial performance of small and medium enterprises in Nairobi County, Kenya. It also gives an overview of areas for future research.

5.2 Summary

The objective of the study was to investigate the effect of lending by microfinance institutions on the financial performance of small and medium enterprises in Nairobi County, Kenya. 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. From the study, it has been found that majority of the respondents indicated their business engages in wholesales, as a retailer, and service delivery. The study also found out that the main source of capital for the business (SMEs) was from microfinance institutions, from personal savings and partnership. The study also found that the challenges faced by the enterprises in accessing loans from MFIs are stringent repayment terms, long time taken processing the loan, and difficulty raising the collateral.

The study also found that stiff competition from bigger firms affects the growth of SMEs, poor management of SMEs is one of the factors affecting their growth and development, SMEs increase their productivity through getting funds from MFIs which leads to enterprises growth, MFIs contribute to the increase of entrepreneurs who start new venture while SMEs fail to expand due to limited financial resources.

5.3 Conclusion

The study found that the main source of capital for Small and Medium Enterprises is from Microfinance institutions. These institutions provide a comprehensive range of financial services to people working in informal sectors which best fits their needs and affordability. They subsequently provide different services to a client, most commonly in the form of a loan. These services lead to the client modifying his/her 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 Majority of the respondents said that poor access to loans and limited finance as the main causes limiting the growth of SMEs. . This study is in line with one carried out by Carpenter and Peterson (2002) he argues that firms whose needs exceed their internal resources may be constrained to pursue potential opportunities for growth. The insufficient internally generated liquidity is therefore one of the factors which are frequently cited as the causes of SMEs failure in developing economies. The respondents strongly agreed stiff competition from bigger firms affects the growth of SMEs. The fact that the share of SMEs has increased in countries suggests that efficient SMEs have actually been able to deploy new strategies in order to maintain, or even enhance their competitiveness in a globalized economy. Further the study found out that, poor management of SMEs is one of the factors affecting their growth and development. SMEs need to improve the skills of the poor borrowers and educate them in marketing and management in order to improve their productivity and income.

The study established the effect of lending by Microfinance Institutions on the Financial Performance of Small and Medium Enterprises in Nairobi County, Kenya. Data has been analyzed by applying both descriptive and inferential. A large number of the SMEs in Nairobi County are beneficiaries of the MFIs loaning services. It can be concluded that Microcredit allows poor people to plan for their future and to put their children to school for longer periods. MFIs should encourage low repayment rates which lead to the granting of new loans for several periods. The findings show that self-selected groups have slightly higher willingness to repay. In situations where the members of the group are able to verify the outcome of the economic activities of the other members and punish them if they default, incentives to cooperate are proven to be stronger. Management in businesses should be improved in order to increase their productivity and income.

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 SMEs 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 from the Microfinance Institutions and also minimize the collateral conditions.

The study recommends that access to finance should be identified as a freedom to growth of SMEs. The study also recommends Training as crucial for productivity and quality as well as it influences the effectiveness, efficiency and motivation of the employees. The study recommends that strong evidence of access to financial services and the resultant transfer of financial resources to poor women, over time, lead to women becoming more confident and assertive. The study also recommends good management of SMEs as one of the factors affecting their growth and development.

5.5 Limitations of the Study

To cover all the SMEs operating in the entire Nairobi County was impossible because of limited time frame and resources for this research study. For this reason, the research only covered 120 SMEs which have operated for five or more years within Nairobi County. The choice of Nairobi County was due to the fact that a large number of SMEs operate within the County thus providing good source of data for the study.

The study findings were limited to respondents level of literacy in provision of responses to the research questionnaire thus limiting the number of respondents participation.

Furthermore, collecting data from different SMEs was also challenging as in there was no assurance that the respondents would return all the questionnaires dully completed so this forced the researcher to personally administer the questionnaire to the various enterprises.

5.6 Areas for Further Research

There is need for further research to be undertaken on the Economic Challenges Affecting Microfinance Institutions in financing small and Medium Enterprises.

A similar study on the effect of lending by Microfinance Institutions on the financial performance of small and medium enterprises in other Counties within Kenya apart from Nairobi County can also be explored

In addition, it will be interesting to explore ways by which the Government can promote the accessibility of credit by SMEs from other financial institutions other than the microfinance Institutions.

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APPENDICES

APPENDIX I: Introduction Letter

Nixon Amuka Oborah,

University of Nairobi,

School of Business

P. O. Box 30197.

NAIROBI.

Dear Respondent,

I am a student at The University of Nairobi pursuing an MBA-Finance Option course. In partial fulfillment of the course requirements, am conducting a research survey on the effect of Lending by Microfinance Institutions on the growth and development of small and medium enterprises, a Case Study of Nairobi County, Kenya. With regards, I request you to spare a few minutes to fill in the questionnaire as diligently as possible. The information in this questionnaire was strictly confidential and was not be used for any other purpose other than for this research. Your assistance in facilitating this research was highly appreciated.

Thanks in advance.

Yours Sincerely,

Nixon Amuka Oborah.

APPENDIX II: Questionnaire for SMEs

Dear Respondent,

This questionnaire is aimed at gathering primary data on the effect of Lending by Microfinance Institutions on the Growth and Development of Small and Medium Enterprises, a Case Study of Nairobi County, Kenya.

Please note that your views and answers to these questions will be treated with greatest confidentiality.

Instructions on how to fill the questionnaire

i. Fill in your answer to all the Questions in the spaces provided
ii. Do not indicate your name anywhere in the questionnaire
iii. It is absolutely important that all questions have a response
iv. There are no wrong or right answers

SECTION A: Background Information

1. Kindly indicated your gender

a. Male ☐

b. Female ☐

2. Kindly indicate the level of your Education background?

a. Primary ☐

b. Secondary ☐

c. Post-Secondary ☐

3. How long has the SME been operating?

a. 1-5 Years ☐

b. 5-10 Years

c. Above 10 Years

4. Indicate category under which the SME falls in.

    a. Sole Proprietorship

    b. Partnership

SECTION B: The type of business the enterprise is engaging in, credit accessibility and challenges the SMEs face in getting loans and other services from the MFIs.

1. Kindly tick ( ) one of the options provided showing the type of business the SME engage in , 1-Yes , 2-No

Statement	**1**	**2**
Wholesalers		
Retailers		
Restaurants		
Cosmetics		
Service Delivery		

2. Kindly tick ( ) one of the options provided showing the source of capital for your business (SMEs), 1- Strongly Agree(SA), 2- Strongly Disagree(D)

Statement	**1**	**2**
Personal Savings		
Family		
Microfinance Institutions		

Partnership		
Others		

4 In the table shown below, kindly tick any of the challenges faced by your enterprise in accessing loans from the MFIs, 1-Strongly Agree, 2-Strongly Disagree (SD)

Statement	**1**	**2**
Long time taken processing the loan		
Difficulty raising the collateral		
Stringent repayment terms		
High transaction costs		

5 In the following statement indicate to what extent you agree that growth and development of your enterprises has been attributed to the following parameters 1-Strongly Agree(SA), 2-Agree(A), 3-Un Decided(U), 4-Disagree, 5-Strongly Disagree(SD)

Statement	**1**	**2**	**3**	**4**	**5**
i. SMEs fail to expand due to limited financial resources					
ii. MFIs contribute to the increase of entrepreneurs who start new venture					
iii. SMEs increase their productivity through getting funds from MFIs which leads to					

enterprises growth					
iv. Poor management of SMEs is one of the factors affecting their growth and development					
v. Unfavorable Government Policies and regulations contribute to the growth and development of SMEs					
vi. Stiff competition from bigger firms affects the growth of SMEs					

End: Thank you for your participation