THE EFFECT OF MICROFINANCE SERVICES ON GROWTH OF SMALL AND MICRO ENTERPRISES IN NAIROBI’S INFORMAL SETTLEMENTS

BY

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DECLARATION

This research project is my original work and has not been presented for examination or award in any other University.

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

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DEDICATION

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LIST OF ABBREVIATIONS

GDP : Gross Domestic Product
GoK : Government of Kenya
MFI : Microfinance Institution
NGO : Nongovernmental Organizations
SME : Small and Micro Enterprises
SPSS : Statistical Package for Social Sciences
ABSTRACT
Small and micro enterprises impact greatly on the country's economy as they not only provide employment but also provide a source of revenue for individuals especially in the Nairobi informal settlements which have the highest number SMEs. Though the SMEs may be easily started, what highly determines their existence and profitability is their growth of which lack of finance has been identified to be the major constraint. This is attributed to the fact that most of the SMEs lack the securities required in order to access credit from banks and other financial institutions. The emergence of microfinance provided reprieve for SMEs by providing them with credit and other services. This study sought to determine the effect of microfinance services on growth of SMEs in Nairobi's informal settlements. The study adopted a descriptive research design. The study population was all small and micro enterprises in Nairobi's informal settlements. A sample of 100 SMEs was selected using a simple random sampling technique. This number was considered appropriate due to time and cost constraints. The study used primary data which was collected using questionnaires. Descriptive analysis was employed to analyse data. Multiple regressions were used to analyse the quantitative data which were analysed using the Statistical Package for Social Sciences (SPSS). The study found that microfinance services (credit finance, training and savings) have positive effect on growth of SMEs in Nairobi’s informal settlements. However, credit finance alone has negative effect negative effect on growth of SMEs. The study concluded that there exists a strong positive relationship between microfinance services combined and growth of the firms. Microfinance services account for over 60% of the changes in growth of the firm. This is irrespective of the fact that credit finance alone has negative effect on growth of the firm. The study recommended that microfinance institutions to enhance their outreach and reach as many SMEs which would go a long way in promoting SMEs growth and to reduce the interest charged on loans advanced to the SMEs.
CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

The economic development of a country primarily depends upon the establishment of small and micro enterprises (SMEs) which provide employment to majority of the country’s population (Kessy and Temu, 2010). This is more so in developing countries like Kenya where poverty and unemployment is widespread. Specifically, in Nairobi’s informal settlements, poverty and unemployment are two burning problems of the country today. SMEs solve these two problems by providing employment, with lower investments.

Microfinance is a form of financial services for entrepreneurs and small businesses lacking access to banking and related services (Yunus, 2006). The two main mechanisms for the delivery of financial services to such clients are relationship-based banking for individual entrepreneurs and small businesses; and group-based models, where several entrepreneurs come together to apply for loans and other services as a group. Microfinance is that part of the financial sector which comprises formal and informal financial institutions, small and large, that provide small-size financial services to all segments of the rural and urban population, in practice however mostly to the lower segments of the population (Goswami, 2014).

Small and micro enterprises lack adequate physical capital (loan access and savings) as well as human capital (skill acquisition and education) and bonding which force them into quest for micro-finance. Unemployment, low household and business income, lack of asset collateral required by conventional banks, high interest rates, their inability to save, small nature of the firms, age of their firms and type of industry they engage, less sales turnover and low survival rate due to low start-up capital, and less growth oriented forms the characteristics of SMEs. Therefore, providing SMEs with micro-finance loans would create an opportunity for them to engage in new business or improve an existing one thereby leading to business performance in terms of increased income. SMEs are important in improving informal settlement lifestyle and hence SMEs improvement should form part of a country’s development strategy (Bett, 2014). From this perspective, microfinance services will lead to growth of SMEs (McKernan, 2002); however, the cost of microfinance borrowing should also be considered.
The cost of borrowed funds depends on the risk level which is influenced by the available information relating to the borrower. SMEs often do not have audited financial statements. Larger firms, on the other hand, must disclose a large amount of information about their financial standing on a systematic basis. As a result of this information void, the investor in small firms is unable to distinguish between high quality and low-quality companies and therefore raises the firm's cost of funding to compensate for risk. The investor will require a high rate of return in exchange for investing in a firm without all of the proper information. The investor requires this higher rate of return because the information is not available to establish the extent to which the small firm is likely to default. This actually limits small firms in accessing external fund (Weinberg, 1994). The high cost of financing therefore may outdo any benefit that may accrue from the use of microfinance.

1.1.1 Microfinance Services

Microfinance has been defined as a development tool used to create access for the economically active poor to financial services at an affordable price (Oni, Paiko, & Ormin, 2012). It is the provision broad range of financial services to the low-income group and micro entrepreneurs to enable them build sustainable microenterprises (Muktar, 2009). It is the concept of provision of small-size financial services especially but not limited to the lower segment of the rural and urban population. These financial services are provided by formal and informal financial institutions; both small and large (Oni, et al., 2012). Microfinance is not just about giving micro credit to the poor rather it is an economic development tool whose objective is to assist poor to alleviate poverty and become self dependent. Micro Finance Institutions were established to enable the poor without collateral security access credit funds at affordable and friendly terms and small savers to accumulate wealth (Goswami, 2014).

Micro finance services refer mainly to small loans; savings mobilization and training in micro enterprise investment services extended to poor people to enable them undertake self-employment projects that generate income. Micro finance came into being from the appreciation that micro entrepreneurs and some poorer clients can be ‘bankable’, that is, they can repay both the principal and interest, on time and also make savings, provided financial services are tailored to suit their needs (Leseyio, 2014). Micro finance is perceived as the provision of financial and non-financial services by Micro Finance Institutions (MFIs) to low income groups without tangible collateral but whose activities are linked to income
generating ventures (Ledgerwood, 1999). These financial services include savings, credit, payment facilities, remittances and insurance. The non-financial services mainly entail training in micro enterprise investment and business skills. There is also a belief that micro finance encompasses micro credit, micro savings and micro insurance (Leseyio, 2014).

1.1.2 Growth of Small and Micro Enterprises

Although there is no universally agreed definition of SME, some of the commonly used criteria are the number of employees, value of assets, value of sales and size of capital as well as turnover. Micro enterprises refer to firms which employ less than five full time workers while small firms refer to those employing between 5 and 49 workers (GoK, 2005). The European Union (EU) categorizes firms with fewer than 50 employees as small and those with fewer than 250 employees as medium (EU Commission, 2003). This is the definition of SMEs adopted in this study.

Small and micro enterprises face a large number of problems, including Lack of finance (Funds), technological lag, managerial inefficiency etc. The crux of the problem is very often that of finance. SMEs are very poor and have little to offer as security for raising finance. Small scale businesses use credit/loans from micro finance institutions (MFI) to finance their business operations and others use the credit to set up business (Goswami, 2014).

Experts have widely acknowledged the substantial contribution of small and micro enterprises (of which women participation constitute larger percentage) to the socio-economic development of a nation, therefore the need to support them to grow. As a result, a number of initiatives have been taken by governments, donors and non-government organizations (NGOs), both local and international to increase the growth of small and micro enterprises in Kenya (Bett, 2014).

Further, SMEs in Kenya play a vital role in job creation and elimination of poverty. Small and micro enterprises constitute to the majority of businesses in Nairobi County and mostly the informal settlements. In Kenya, SMEs create the highest number of new jobs per year. In 2009, SMEs created 79.9% new jobs out of 543.3 thousand new jobs created in Kenya. In the same year, the sector contributed 59% percent of total GDP (GoK, 2009). In 2013, SMEs sector contributed 89.7% of new jobs created in 2013 (GoK, 2013).
There is no one single measure of SME growth. Growth can be measured in many ways such as turnover, profits, and number of people employed and in market and technology domain. The growth of a firm is a measure of performance of an enterprise and is a function of its ability to reach and maintain equilibrium with its environment according to (Gormoma, 2001). According to Marry (2004), the growth of an enterprise is reflected in increased sales, new and improved products and increased market share. For this study, growth was measured by the percentage increase in sales per year.

1.1.3 Microfinance and Small and Micro Enterprises Growth
The contribution of microfinance to SME’s growth lies in it assisting to overcome their capital problem. Due to low assets base, bank demand for collateral denies most SMEs access to capital. Kanak and Iiguni (2007) explains that the poor who often engage in SMEs produce at subsistence level hence difficulty to accumulate savings or assets that could guarantee access to credit from formal finance. MFIs type of loans are usually small size and because collateral is de-emphasized, greater access is avail SMEs to capital. Most SMEs operators are illiterate thus lack the knowledge and skills in certain acts of business such as record keeping; an act Ormin (2008) has noted as an imperative for business success. This scenario is both a limitation to access to bank finance and reliable source for business decisions. The absence of record keeping couple with poor managerial skills results to poor decision making which impacts on the performance and growth of the enterprises. It could be in realization of this that Matu and Kimani (2010) advocated MFIs greater commitment to the provision of non-financial services especially basic entrepreneurial training.

Accessing credit is considered to be an important factor in increasing the development of SMEs. It is thought that credit augments income levels, increases employment and thereby alleviates poverty. It is believed that access to credit enables poor people to overcome their liquidity constraints and undertake some investments such as the improvement of farm technology inputs thereby leading to an increase in agricultural production (Hiedhues, 1995). Access to micro-finance has the potential to assist the poor in earning income from microenterprises, smooth their income and consumption help households diversify their income sources (Zeller, 1999).

The Microfinance industry has become a major backbone in the sustenance and survival of SMEs in Kenya at large. Microfinance Institutions (MFIs), as part of their core business,
provide credit to SMEs. In addition to these financial services, MFIs also provide non-financial services like business training, financial and business management to help improve the capacity of their clients in managing the loan resources granted to them. The number of MFI institutions that provide microfinance services continues to grow rapidly with their wide presence not corresponding with the growth of SMEs. From the knowledge of microfinance, access to credit should enable the SMEs to achieve growth (Ngugi and Kerongo, 2014).

1.1.4 Informal Settlements in Nairobi

Kenya is facing an increasing growth of informal settlements in her urban centres. The informal settlements are characterized by large number of small and micro enterprises. Further, in attempt to improve the standards of living in these informal settlements, the government and nongovernmental organizations have been supporting these businesses in form of microfinance. Informal settlements have a long history in Nairobi dating from colonial period, where most Africans were barred from the city’s designated residential areas since they were reserved for Europeans and Asians. Kenyans who came to the city in search of work had to create informal residential settlements outside the central business district and the planned residential areas which were largely ignored by the colonial government (Amnesty International, 2009). Mitullah (2003) argues out that the city’s first development plans did not include early settlements; hence essential services to the settlements and road construction to link them to other areas of the city were not provided by the local authorities. As a result, Nairobi developed along segregated lines. The city’s 1948 Master Plan and other major urban development plans continued to neglect informal settlements.

The informal settlements are scattered within Nairobi’s nine administrative divisions. Residents in these marginalized areas live in very inhumane and disturbing conditions with severe lack of clean water supply, improved sanitation, housing, health services, and lack of solid waste management facilities (Umande Trust, 2003). In addition to this, slums dwellers face inadequate schooling facilities, unemployment, lack of energy, lack of drainage systems, high crime rates, and lack of proper governance including security services. These problems are expected to be addressed by improved performance and growth of SMEs which forms the backbone of the informal settlements economy.

As rapid urbanization takes its toll, so has the development and growth of slums. More than 34% of Kenya’s total population lives in urban areas and of this, more than 71% is confined
in informal settlements (UN-Habitat, 2009). This number will continue to increase unless a serious and concerted action by all relevant stakeholders is undertaken. Kenya’s annual informal settlements growth rate of 5% is the highest in the world and it is likely to double in the next 30 years if positive intervention measures are not put in place (UNDP, 2007). The experience in these slums shows a strong link that people living in poverty are trapped in their present (World Economic and Social Survey, 2008) situation because they are excluded from the rest of the society. Unfortunately, they are not empowered to allow them to make any significant contribution to community building (Mutisya, 2010), pushing Nairobi city to the verge of sinking into abyss as the weight of mushrooming slums takes its toll.

This has resulted to life threatening outcomes which lead to mass poverty, contagious diseases, conflicts, and other social, ecological and economic hazards. Kibera informal settlements (began in 1912) have an estimated population of 950,000 people, while Mathare slums (started in 1963) houses more than 500,000 people, Korogocho slums (started in 1980s) has an estimated population of 150,000 people and Mukuru Kwa Njenga (began in 1958) has an estimated population of 100,000 people (Umande Trust, 2007).

1.2 Research Problem
Lack of access to finance has been identified as one of the major constraints to small and micro business growth (Carpenter, 2001; Lawson, 2007). This can be explained by the fact that provision of financial services is an important means for mobilizing resources for more productive use (Watson and Everett, 1999). Microfinance services are believed to facilitate access to financing to small businesses by determining the extent to which small firms can save and accumulate own capital for further investment (Hossain, 1988). The inability of the SMEs to meet the standard of the formal financial institutions for loan consideration provides a platform for informal institutions to attempt to fill the gap usually based on informal social networks giving rise to micro-financing (Portes, 1998). The challenge of capital and other non-financial measures confronting the establishment and growth of SMEs remarkably does not only promote poverty but affects the pace of economic growth and development (Oni, et al, 2012).

In order to enhance the flow of financial services to the micro and small enterprises (SMEs) subsector in Nairobi’s informal settlements, the government of Kenya and nongovernmental organizations have in the past initiated a series of programmes and policies targeted at the
enhancing SMEs access to financing. It is on this ground that the proposed study intends to examine the effect of microfinance services on small and micro enterprises growth. Determining whether access to financing on SMEs growth in informal settlements will be of importance to the government and NGO interested in improving lives of informal settlement dwellers. In addition, numerous studies have found that access to microfinance access leads to growth of SMEs, considerable number of studies has found microfinance services benefits are outdone by the financing costs and repayment of the finances (Ochanda, 2014).

In attempt to understand the effect of microfinance on SMEs, numerous studies have been done in Kenya. Leseyio (2014) studied the effect of microfinance services on financial performance of small medium and enterprises in Narok County. Bett (2014) studied the influence of microfinance institutions services on growth of women owned small and micro enterprises in Ainabkoi Sub-County, Uasin-Gishu County, Kenya. Ngugi and Kerongo (2014) studied the effects of micro-financing on growth of small and micro enterprises in Mombasa County and established a positive effect of microfinance and SME growth. However, none of these studies has studied the effect of microfinance services on growth of small and micro enterprises in informal settlements where microfinance movement is rampant. Hence this study provided information to bridge the gap that exists in literature on the effect of microfinance services on growth of SMEs in informal settlements and consequently lead to their improved performance and job creation. The study answered the research questions;

i. What is the significance of microfinance services in formation and growth of SMEs?
ii. What is the role of microfinance services on SMEs access to credit?
iii. What is the effect of microfinance loans on financial performance of SMEs?

1.3 Objectives of the Study

1.3.1 Main Objective

To establish the effect of microfinance services on growth of SMEs in Nairobi’s informal settlement.
1.3.2 Specific Objectives

i. To determine the significance of microfinance services in formation and growth of SMEs

ii. To establish the role of microfinance services on SMEs access to credit

iii. To examine the effect of microfinance loans on financial performance of SMEs

1.4 Value of the Study

The research findings are of significance to various parties who include the government, nongovernmental organisations, owners of microfinance institutions, general public and researchers and academicians. To the government, this study provides information on the role of microfinance services on growth and performance of SMEs. This enables the government in policy formulation aimed at fostering performance of SMEs and consequently solving the challenges in Nairobi’s informal settlements.

The findings also enable nongovernmental organisations whose mission is to upgrade informal settlement lives to better achieve their objectives. They are able to know the microfinance services that the SMEs in these informal settlements need to achieve their growth. This goes a long way in creation of employment and changing of lifestyle in the informal settlements.

To the SMEs owners and entrepreneurs, they get a chance to learn the about better ways of managing their business and the services they can acquire from microfinance institutions to enable their firms grow. This implies increased profitability for the firms and hence increased income to the entrepreneurs. To the general public, accelerated SMEs growth as a result of the study recommendations implies more employment opportunities and reduced social problems like insecurity in informal settlements.

Further, the research provides information on the relationship between microfinance services and SMEs growth which form the basis of future studies and hence bridge the empirical gap that exists in literature.
CHAPTER TWO
LITERATURE REVIEW

2.1 Introduction
This chapter reviews existing literature that is related either directly or indirectly to the study on microfinance services and small and micro enterprises. The chapter has reviewed both empirical and theoretical literature on microfinance and SME growth and performance. The chapter also has discussed the determinants of SME growth and ends with a chapter summary.

2.2 Theoretical Review
A number of theories were noted to be essential in explaining the relationship between microfinance credit and SME growth and why firms will consider using credit. The theories include pecking order theory, financial growth theory and contract theory.

2.2.1 Pecking Order Theory
The pecking order theory was proposed by Myers (1984). It sheds light on the incentives that drive SMEs capital structure decisions. This theory proposes that firms prefer to use internal sources of capital first and will resort to external sources only if internal sources are inadequate. Majority of SMEs start with internal financing before looking for external sources. However, more often than not, internal financing is usually not adequate unlike in older firms which by definition have had more opportunities to accumulate retained earnings than younger companies and thus more funds are available to finance operational growth. Pecking order theory suggests that those funds should be used before external capital sources are tapped. Holmes and Kent (1991) found that small businesses experience a more intense version of pecking order in their decisions because access to appropriate external sources of capital is limited. It has been noted that small businesses’ differ in their capital structure but their intense reliance on pecking order is only one of the variables that make small businesses financing decision unique.

When lending to small businesses, most financial institutions require the owners of the small businesses to personally guarantee the loan. These personal guarantees allow the institution recourse against the personal wealth of the small businesses owner in the event of default (Berger and Udell, 1998). These restrictions on the type of finance available to SMEs coupled
with the small firm’s insistence on first using internal sources of capital (Holmes and Kent, 1991), creates a unique structure for small business. Romano, et al., (2001) describe the situation as a complex array of factors that influence small to medium size enterprises (SME) owner-manager’s financing decisions. This is supported by Hall et al. (2000) who found that firm’s size is positively related to long-term debt and negatively related to short-term debt. In further support, Chittenden et al. (1996) suggest that a firm’s size is correlated with the firm’s reliance on pecking order theory in capital structure decisions. Thus, smaller firms are more likely to rely on internal funds. Romano et al. (2001) found a significant relationship between the size of the firm and the use of debt. Again, these results are consistent with pecking order theory and the Berger and Udell (1998) model.

2.2.2 Financial Growth Theory

The theory was proposed by Berger and Udell (1998) to explain how firm’s financial needs and financing options change as the business grows, becomes more experienced and less informationally opaque. They further suggest that firms lie on a size/age/information continuum where the smaller/younger/more opaque firms lie near the left end of the continuum indicating that they must rely on initial insider finance, trade credit and/or angel finance. The growth cycle model predicts that as firm grows, it will gain access to venture capital (VC) as a source of intermediate equity and mid-term loans as a source of intermediate debt. At the final stage of the growth paradigm, as the firm becomes older, more experienced and more informationally transparent, it will likely gain access to public equity (PE) or long-term debt.

In line with financial growth theory, numerous empirical studies have found that inadequate financing was the primary cause of SME’s failure (Jones, 1979; Coleman, 2000; Ochanda, 2014). The capital structure of smalls firm differs significantly from larger firms because small firms rely more on informal financial market which limits the type of financing they can receive. The small firm’s initial use of internal financing creates a unique situation in which capital structure decisions are made based on limited financing options. It is widely accepted that small firms have different optimal capital structures and are financed by various sources at different stages of their organizational lives (Berger and Udell, 1998). Researchers have found that certain attributes of small firms influence the type of funds available to finance the firm’s operations (Hall et al., 2000, Romano et al., 2001).
2.2.3 Micro Credit Theory
Theoretical idea of micro credit has been derived from economic theory that forms the foundation of the credit business in non-communist society. Adam Smith (1976) conceived this theory in the eighteenth century that Self-seeking individuals are always eager to employ their labour, capital and skills to their best interests, which eventually add up to the benefit of the entire society due to the work of the “invisible hand”. Smith’s idea, later popularized as the theory of capitalism by Karl Marx, describes the principles of material prosperity of the non-communist society. The psychological component of micro credit theory known as “social consciousness driven capitalism” has been advanced by most ardent promoter of micro finance Yunus (1994). This theory argues that a species of profit-making private venture can be conceived that cares about the welfare of its customers. In other words, it is possible to develop capitalist enterprises that maximize private profits subject to welfare considerations of their customers (Ngugi and Kerongo, 2014).

2.3 Determinants of Small and Micro Enterprises Growth
The primary task for any business regardless of its size, capital, ownership and nature is to earn profit. Several factors which have been found to be the main determinants of SMEs profitability which include microfinance services, SME industry, age of SME and legal composition of the SME.

2.3.1 Microfinance Services
Micro credit institutions have emerged as a substitute for formal financial institutions which have limited the accessibility to credit by the poor due to lack of collateral (Choudhury et al. 2008). It is an important source of income for many poor people in low developing countries. Recognizing this, governments and donors have sought to promote small firms usually through credit programmes. Many developing countries have supported microfinance services because they offer the rural poor access to flexible financial services as well as improving their welfare. Micro credit institutions enhance household’s capacity through financing investments promoted by the poor. Micro credit covers abroad range of financial services including loans, deposit, payment service, insurance to the poor and their micro enterprises (Bett, 2014).

In many rural areas of developing countries, lack of access to formal financial services has be seen as a sever constraint that prevents low income households from improving their
incomes. For instance as observed by Mohammad, 2008 over 500 million poor people in developing countries with small businesses have often cited limited access to formal financial institutions for credit as the biggest challenge to their business growth. With the success of Grameen bank a micro credit institution in Bangladash where the low income households have been able to access credit and as a result their household income has improved, accessing micro credit by the rural poor is therefore a viable option for the rural poor to use while improving their household income. The accessibility to credit is all aimed at improving the household incomes of the poor people (Bett, 2014).

The accessibility to credit by the poor people enables them to mobilise capital which supports them in starting businesses. This leads to increased productivity and ownership of assets which eventually improves their household income. The accessibility to credit is made easy by the credit institutions defining their credit limit which refers to the amount of credit that an institution is willing to give out to the potential borrowers (maximum & minimum). It’s a determinate in accessing credit by the potential borrowers since most often they know their credit needs better than anybody else (Bett, 2014).

Yunus (2006) describes microfinance as an amazingly simple approach that has been proved to empower very poor people around the world to pull them out of poverty. A key to microfinance is the recycling of loan. As each loan is repaid-usually within six months to a year-the money is recycled as another loan, thus multiplying the value of each loan in defeating global poverty and changing lives and communities. He further explains that microcredit refers specifically to loans and the credit needs of clients, while microfinance covers a broader range of financial services that create a wider range of opportunities for success.

Consultative Group to Assist the Poor (CGAP) reiterated that, microfinance allows poor people to protect, diversify, and increase their sources of income. Microfinance helps to cushion poor households against the extreme vulnerability that is a feature of their everyday existence and which can push a family into destitution. Loans, savings, transfers and insurance help to smooth out income fluctuations and maintain consumption even during lean periods and emergencies. Microfinance is thus reported to be capable of giving more people more options, empowering them to make their own choices and build their own way out of poverty (CGAP, 2009).
2.3.2 Industry
Industry factors significantly determine SMEs profitability whereby a number of studies carried out to identify the influence of a firms industry on the profitability of the firm concur that there are significant differences between sectors in terms of the typical profitability of the firms. Only a few studies show sector variables not to be significant (Barkham et al., 1996). Some industries are known to have higher firms’ profitability than others mostly depending on capital required to be invested in assets and the level of sales. The degree of concentration in an industry also determines firm profitability. A higher concentration enables collusion between firms which can lead to higher profits. Industry effect models argue that differences in industry-level characteristics, such as efficiency level, industry structure or quality of top management firms and specific industry regulations cause differences in profitability (Stierwald, 2009). In addition, sectors that require more capital investment in equipment, machinery, buildings, labour and raw materials have fewer finances hence are less profitable.

2.3.3 Age
The age of the SME is an important factor influencing the profitability of the firm (Barkham et al., 1996). Age of a firm helps in determining the competitive advantage of the firm over other firm and it also help the firm to design its competitive strategies. Age of the firm also leads to the creation of firm image in the eyes of customer which leads to increased sales for the firm and firm increased profit. An SME that has been in existence for long also has a large market share which plays a key role in identification of firm profitability and its position in the industry and is also able to identify the level of competition and the way to form all lever of strategies (corporate level, business level and product level) to counter that competition (Raza, Farooq, and Khan, 2011).

2.3.4 Legal Composition
Theoretically, a firm constituted such that the owner/managers enjoy limited liability has been said to have a greater incentive to pursue risky projects and therefore expects higher profits than other firms (Stiglitz and Weiss, 1981). Further, firms with limited liability and owned by more than one person are usually well structured, professionally managed and operated and therefore have high, stable and consistent profitability growth. Foreman et al. (2006) found that the positive effect of partnership on profitability was twice as large as that
of the sole trader, taking limited liability and subsidiaries as the base case; this was explained by interpret the effects as risk tolerance and division between many individuals.

2.4 Empirical Review

Hulme (1997), conducted various studies on different microfinance programmes in numerous countries and found strong evidence of the positive relationship between access to a credit and the borrower's level of income. Mosley (2001) evaluated the impact of loans provided by two urban and two rural MFIs on poverty in Bolivia. He found that the net impact of microfinance from all institutions, at the average level, was positive in relation to borrowers’ income, even though the net impact for poorer borrowers might be less than the net impact on richer borrowers.

Copestake (2002) conducted a case study of the Zambian Copperbelt, applying the village bank model to investigate the effect on income distribution at the household and enterprise levels. The study showed that the impact on income distribution depends on who obtains the loan, who moves on to larger loans and who exits the programme: group dynamics was also an important factor. He notes, some initial leveling up of business incomes was found, but the more marked overall effect among borrowers was of income polarization. McKernan (2002) evaluated three significant microcredit programmes in Bangladesh and discovered that the profit for self-employed activities of households could be increased by programme participation.

Khandker (2005) observes microfinance supports mainly informal activities that often have a low return and low market demand. It may therefore be hypothesized that the aggregate poverty impact of microfinance is modest or even nonexistent. If true, the poverty impact of microfinance observed at the participant level represents either income redistribution or short-run income generation from the microfinance intervention. Khandker's article examines the effects of microfinance on poverty reduction at both the participant and the aggregate levels using panel data from Bangladesh. The results suggest that access to microfinance contributes to poverty reduction, especially for female participants and to overall poverty reduction at the village level. Microfinance thus helps not only poor participants but also the local economy.
Matovu (2006), using pooled data from Uganda, concludes that all the women clients reported increase in their incomes which has improved their standard of living, enabled them to send their children to school; pay their medical bills, feed their families, and cope with future crises using their savings; the women have been empowered economically. He also notes that well functioning market, entrepreneurial skills and other infrastructure support microfinance to achieve results. However, some of the findings may not be conclusive; one should therefore be careful in drawing conclusions there from. Kotir and Odoom (2009), in a study of 139 households in one rural area of the Upper West Region of Ghana, found that, (a) Beneficiaries of micro-credit divert a significant portion of such loans into household consumption – albeit with moderate impact on household productivity and welfare and (b) Micro-credit has modest impact on rural community development.

Garmaise and Natiridada (2010) provide direct evidence on the impact of asymmetric information on both financing and operating activities through a study of credit evaluations of microfinance institutions (MFIs). They employ a regression discontinuity model that exploits the eligibility criteria of an evaluation subsidy offered by a non-profit consortium. The evaluations dramatically cut the cost of financing and found the effect strongest for commercial lenders and for short-term MFI lender relationships. The impact of evaluations on the supply of finance is mixed. Evaluated MFIs lend more efficiently, extending more loans per employee.

Oni, et al., (2012) assessed the Contribution of Micro Finance Institutions (MFIs) to sustainable growth of small and medium scale enterprises (SMEs) in Nigeria. The study employed the survey research method. Secondary sources and primary data were used. Secondary sources consisted of papers published in academic journals, paper presentation at conferences, text books, government gazette, and materials posted on the internet. Primary data consisted of first-hand information collected from the field through questionnaire and interview. The study found that microfinance services contributed to sustainable growth of SMEs in the country. The study recommended for periodic review of microfinance activities by regulators.

Bett (2014) studied the influence of microfinance institutions services on growth of women owned small and micro enterprises in Uasin-Gishu County. The study adopted both the qualitative and quantitative analysis in order to achieve the objective of the study. The study
established that women needed collaterals to qualify for micro credit facilities while the application procedures were cumbersome and tiresome and hence they could not easily access microfinance. The study recommended that the design of micro savings should be changed to align to the client’s needs such that withdrawal procedures should be made easier and the time period for consequent withdrawals be reduced; and that the government to partner with the MFIs and conduct civic education to reach out to the small scale entrepreneurs as well as to the potential entrepreneurs to seek the services of microfinance banks as a way of ensuring poverty alleviation in the rural areas.

Goswami (2014) studied the role of microfinance in small scale industries in India using descriptive research design. The study used secondary data collected from various publications including nongovernmental organizations and government. The study found that the small enterprises were playing an important role in improving the standard of living of the people and transforming the economy of a nation at large. The main challenge facing small enterprises was that of capital. The study recommended that the government and MFIs themselves to enhance the out-reach of microfinance through creating awareness of the activities and operations to Small Scale Enterprises especially those in rural and semi-urban areas that were yet to appreciate the benefits of the microfinance services.

Leseyio (2014) studied the effect of microfinance services on financial performance of small medium and enterprises in Narok County. The study adopted a descriptive research design, had a sample of 93 enterprises and collected data using structured questionnaires. The study established that the existence of microfinance services had contributed to the development of SMEs with provision of credit increasingly been regarded as an important tool for raising the incomes of youths, mainly by mobilizing resources to more productive uses; making credit more accessible, the rates for borrowing and the lending rates have been lowered at fair rates for easy access and availability to credit hence the financial performance of the SMEs is increased and the promotion of SMEs and, especially, of those in the informal sector is viewed as a viable approach to sustainable development because it suits the resources in Narok County. The study recommended that basic business skill training to accompany the provision of micro loans to improve the knowledge of the poor to use these funds in growth of their enterprises.
Ngugi and Kerongo (2014) studied the effects of micro-financing on growth of small and micro enterprises in Mombasa County. The study adopted descriptive survey stratified and systematic random sampling method and data collected using questionnaires. Sales, income and competitiveness were used as the independent variable while growth of SMEs as dependant variable. Results indicated that microfinance has positive effects on growth of SMEs. Majority of the owners indicated that microfinance has enabled them to expand businesses, build their business assets. Also ability of the business to complete was enhanced.

2.5 Summary of Literature Review

From reviewed literature, numerous studies have been done on SME, growth and determinants of growth. However, minimal empirical literature exists on the effect of microfinance services on growth of small and micro enterprises in informal settlements where microfinance movement is rampant. Hence this study provided information to bridge the gap that exists in literature on the effect of microfinance services on growth of SMEs in informal settlements and consequently lead to their improved performance and job creation. The study tested empirically the impact of both the financial and non-financial services offered by Microfinance institutions on small business growth/survival and by examining the capability of Microfinance institutions in enhancing the expansion capacity of small businesses in Nairobi informal settlements.

Further, empirical evidence emerging from various studies reviewed indicates mixed results that are inconclusive especially for developing countries cases like Kenya. Additionally, previous studies have not provided sufficient justification for the link between micro financing and SME growth in the developing countries like Kenya, therefore the question of whether micro financing improves or worsens SME growth is stills worthy of further research such as the one being undertaken in this study. In addition, the effects of micro financing on the growth of SME have not received adequate attention in Informal settlements.
CHAPTER THREE
RESEARCH METHODOLOGY

3.1 Introduction
Methodology refers to the application of the principles of data collection methods and procedures in any field of knowledge to help answer the research questions. This chapter discusses the procedures which were followed in conducting the study. The chapter contains the research design, population of the study, sources and type of data, sampling design, data collection and data analysis.

3.2 Research Design
Research design is the plan and structure of investigation so conceived as to obtain answers to research questions (Kothari, 2008). The study adopted a descriptive research design which determines and reports the way things are (Mugenda and Mugenda, 2003). Creswell (2003) observes that a descriptive research design is used when data are collected to describe persons, organizations, settings or phenomena. The design also has enough provision for protection of bias and maximized reliability (Kothari, 2008). A descriptive study is concerned with determining the frequency with which something occurs or the relationship between variables (Cooper and Schindler, 2003).

3.3 Population
Population refers to an entire group of individual or objects having common observable characteristic. According to Cooper and Schindler (2003), a population is the total collection of elements about which we wish to make some inferences. The idea is not far from Mugenda and Mugenda (2003) view which define a population as the entire group of individuals, events or objects having a common observable characteristic. It should be ensured that population selected is representative and that everyone has an equal chance to be included in the final sample that is drawn according to (Mugenda and Mugenda, 2003).

The study population consisted of all small and microenterprises in informal settlements in Nairobi County. The informal settlements from which the study population fell are Kibera, Mathare slums, Korogocho and Mukuru Kwa Njenga. There was no complete set of data on the number of SMEs in these informal settlements but the number was expected to be over 50,000.
3.4 Sample
Sample size is a given number of members or cases from the accessible population which is carefully selected so as to be a representative of the whole population with the relevant characteristics. A sample is therefore a smaller group obtained from the accessible population (Mugenda and Mugenda, 2003). The researcher used simple random sampling to pick 100 SMEs that were involved in the study. 25 SMEs were be sampled in each of the four informal settlements using simple random sampling. This number was considered appropriate due to time and cost constraints. The simple random sampling procedure was preferred because this concept allowed unbiased sampling and accorded the research work more scientific feature thereby making the validity of the research findings more concrete.

3.5 Data Collection
This study employed questionnaire as a sole means of data collection from respondents which were administered through interviews to ensure accuracy of the information provided. The instrument was divided into two sections. First section contained questions on the business type. The second section was on measures of on growth of SMEs and microfinance service indicators. In order to ensure uniformity in response and to encourage participation, the questionnaire were kept short and structured with mostly multiple-choice selections in a likert scale. According to Mugenda and Mugenda (2003), questionnaires are commonly used to obtain important information about a population under study.

3.5.1 Data Validity and Reliability
Validity refers to the appropriateness, meaningfulness and usefulness of the specific inferences researchers make based on the data collected. Reliability measures the level to which the research instruments yield consistent results or data after repeated trials (Kothari, 2008). Validity determines the relevance of the data in achieving the research objectives. Validity was achieved by structuring the questionnaire in a way that all the study variables were captured. Validity is defined as the accuracy and meaningfulness of inferences, which are based on the research results (Mugenda and Mugenda, 2003). Reliability of the data was achieved by administering the questionnaires to the respondents most of whom were not very literate and any inconsistencies would be corrected at point of data collection. The researcher vetted the information provided and ensures that accurate information was provided.
3.6 Data Analysis

Data analysis involves organizing, accounting for and explaining that data; that is making sense out of data in terms of respondent’s definition of the situation noting patterns, themes, categories and regularities (Kothari, 2008). A descriptive analysis was employed to analyse data. This included the use of table, charts, graphs, percentages and frequencies. Multiple regressions were used to analyse the quantitative data which were analysed using the Statistical Package for Social Sciences (SPSS). Tables, charts and figures were used to present the data collected for ease of understanding and analysis.

3.6.1 Analytical Model

Multiple regressions method was used to analyse data and examine the relationship of dependent and independent variables and took the following format:

\[ Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \varepsilon \]

Where;

\( Y \) is SME growth

\( X_1 \) is the amount of microloan received by the SMEs as a percentage of net assets

\( X_2 \) is total savings done by the SMEs in microfinance institutions as percentage of net assets

\( X_3 \) is number of trainings received by SMEs from microfinance institutions per year

\( X_4 \) is the legal composition of the SME

\( X_5 \) is the SME industry

\( \varepsilon \) is the error term

\( \beta_0 \ldots \beta_6 \) are the various intercepts

3.6.2 Operationalization of Study Variables

The variables in the model were measured using the ratio scale. The dependent variable was determined by rate of change of sales per annum from the year 2010 to 2014. Microcredit was measured by the proportion of total loans received by the SME to its net assets. Savings mobilized by microfinance institutions were measured by total savings as a proportion of
total net assets. Training was measured by the number of trainings attended offered by microfinance institutions and related organizations per year. The details were presented in table 3.1 below. Multiple regression and correlation analysis were carried out to determine the nature of relationship between the dependent variable and independent variables.

Table 3.1: Operationalization of Study Variables

<table>
<thead>
<tr>
<th>Variable</th>
<th>Definition</th>
<th>Type of scale</th>
<th>Measurement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Y</td>
<td>Y is the dependent variable which is the SME growth</td>
<td>Ratio</td>
<td>SME growth was measured by annual growth in sales (sales in year 1-Sales in Year 2)/ Sales in Year 1</td>
</tr>
<tr>
<td>X₁</td>
<td>Microfinance loan which is a measure of microfinance services</td>
<td>Ratio</td>
<td>This was measured by the amount of microloan received by the SMEs as a percentage of net assets</td>
</tr>
<tr>
<td>X₂</td>
<td>Savings which is a measure of microfinance services</td>
<td>Ratio</td>
<td>This was measured by the amount of savings mobilized by microfinance institutions to the SMEs as percentage of net</td>
</tr>
<tr>
<td>X₃</td>
<td>Trainings which is a form of microfinance service offered</td>
<td>Ratio</td>
<td>This was measured by the number of trainings offered by microfinance institutions per year on the SMEs</td>
</tr>
<tr>
<td>X₄</td>
<td>Legal composition of the SME</td>
<td>Nominal</td>
<td>This was measured by coding the legal composition of the SME (Sole proprietorship, 1, Partnership, 2 and Limited company 3).</td>
</tr>
<tr>
<td>X₅</td>
<td>SME industry</td>
<td>Nominal</td>
<td>For analysis, SME industry were Manufacturing (1), Trade (2) and Service (3).</td>
</tr>
</tbody>
</table>
3.6.3 Test of Significance

The significance of the relationship between the dependent and the independent variables was determined at 95% level of confidence using the analysis of the variance (ANOVA), t-tests, z-tests and F-tests. Statistical inference techniques were used in making conclusions relating to the accuracy of the model. Coefficient of correlation and determination was used to show the strength of independent and dependent variables and the level of error in the model respectively.
CHAPTER FOUR
DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction
This chapter provides a summary of the findings, data analysis and discussion of the study on the effect of Microfinance Services on the growth of SMEs in Nairobi’s informal settlements. The data is summarized and presented in the form of frequencies, mean, standard deviation, charts, graphs and tables.

4.2 Background Information
This section sought to obtain essential background information relating to SMEs and the business owners. The data obtained related to location of the firms, industry, the number of years the SME was in operation, SME legal formation and position of the respondents.

4.2.1 Location of the firms
This section aimed at establishing the location of the firms under the study population. The findings show that majority of the respondents at 26% (25) had their SMEs in Mukuru Kwa Njenga and Kibera. This is followed by Mathare slums with 25% and Korogocho slum with 24%. Thus the study population was entirely from the informal settlement areas with each region having almost equal representation showing that the results obtained was not biased on any region.

Figure 4.1: Location of the firms

Source: Research Data
4.2.2 SME Industry
The industry factors highly determine the profitability obtained by the SMEs as some industries are more competitive than others. The study therefore was set out to identify the industries under which the SMEs were operating. The findings obtained are shown in figure 4.2 below. The findings show that 48% (47) of the SMEs were in manufacturing industry, 33% (32) in trade industry whereas 19% (18) were in service industry. This shows that majority of the SMEs were in manufacturing industry. Service industry was established to have the least population of SMEs which could be attributed to the high labor capacity required in the service industry and this could limit establishment of service firms.

Figure 4.2: SME Industry

![SME Industry](image)

*Source: Research Data*

4.2.3 Years of operation of SMEs
The respondents were required to indicate the years in which their SMEs had been operating. The results obtained show that majority of the SMEs were operational for more than ten years 34%. 29% operated for 5-8 years, 15% operated for 2-4 years and 8-10 years whereas only 6% for less than 2yrs as illustrated in figure 4.3 below. The result shows that most of the respondents had their SMEs operation for over 5 years hence they provide accurate and reliable information. The SMEs age determines the competitive advantages of firms (Raza et al, 2011). This is not only due to the knowledgeability of the market structure but also due to creation of the customer loyalty.
4.2.4 Respondents’ Position

This section aimed at establishing the respondents' position in the SMEs. The findings indicated that 53% of the respondents were owners, 18% were line managers, 13% were other staff, and 12% were directors while 4% were partners as shown by figure 4.4 below. As the results show, majority of the respondents were SME owners and they were thus fully aware of the operational practices of the SMEs. The position of the individual determines the level of knowledge on the firm's practices. Additionally it represents the role they play in ensuring success of the firm.

Figure 4.4: Position of the Respondents

Source: Research Data
4.2.5 SME Legal Formation

The section sought to establish the legal formations of the SMEs as it influences the profitability in firms (Stiglitz and Weiss, 1981). Majority of the SMEs (61%) were sole proprietorship, 34% were limited companies whereas 5% were partnership as shown in figure 4.5. This shows that partnership form of business was least preferred. This contradicts the finding by Foreman et al, (2006) who found that partnerships are more profitable and hence more preferred.

Figure 4.5: SME legal formation

![SME Legal Formation Pie Chart]

Source: Research Data

4.2.6 Number of employees in the SMEs

This section aimed at establishing the size of the firm by determining the number of employees at the SMEs. The results obtained are presented in table 4.1 below. The findings indicated that 43% (42) of the SMEs had below 5 employees, 44% (44) had 6-10 employees, 5% (5) had 21-50 employees, 3% (3) had 11-20 employees while 3% (3) had over 50 employees. This shows that majority of the SMEs studied were small since they has less than 10 employees.
Table 4.1: Number of employees in the SMEs

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Below 5</td>
<td>42</td>
<td>43%</td>
</tr>
<tr>
<td>6 to 10</td>
<td>44</td>
<td>45%</td>
</tr>
<tr>
<td>11 to 20</td>
<td>3</td>
<td>3%</td>
</tr>
<tr>
<td>21-50</td>
<td>5</td>
<td>5%</td>
</tr>
<tr>
<td>Over 50</td>
<td>3</td>
<td>3%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>97</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>

_Source: Research Data_

4.3 Microfinance and Small and Micro Enterprises Growth

This section sought to determine the microfinance services received by the firm and the effect the services had on growth of the small and micro enterprises.

4.3.1 Services Received from Microfinance Institutions

The study sought to determine the services received from the microfinance Institutions by the SMEs. As show by table 4.2 below, all the SMEs received loans/credit finance, business trainings and savings. This confirms the fact that micro finance institutions offer diverse services to SMEs which include training, credit and saving services.

Table 4.2: Services Received from Microfinance Institutions

<table>
<thead>
<tr>
<th>Microfinance service</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loans/credit finance</td>
<td>97</td>
<td>100%</td>
</tr>
<tr>
<td>Business advice/trainings</td>
<td>97</td>
<td>100%</td>
</tr>
<tr>
<td>Savings</td>
<td>97</td>
<td>100%</td>
</tr>
<tr>
<td>Others</td>
<td>0</td>
<td>0%</td>
</tr>
</tbody>
</table>

_Source: Research Data_

4.3.2 Microfinance services and SME Growth

The study sought to establish the extent of use of microfinance services and their effect on the SMEs growth. Respondents were required to give responses on a likert scale of 1-5, where; 1 was less favourable; 2 moderately satisfactory; 3 satisfactory; 4 very satisfactory and 5 most satisfactory. Results obtained are as shown in table 4.3 below.
The results show that microfinance services facilitated growth of various business segments to satisfactory levels with mean of above 3. SMEs had major effect on accessibility of the MFIs credit facilities with a mean of 3.8454 (very satisfactory). On the effect of MFIs services on capital investment decisions, business risk management and basic business skills, means of 3.564, 3.5361 and 3.299 respectively were obtained. The findings show that microfinance services contributes to fuelling of both the growth and stability of the enterprises each having means of 3.6804 and 3.4536. The results also show that microfinance services contribute highly to growth of SMEs.

Table 4.3: Microfinance services and Training

<table>
<thead>
<tr>
<th>Statement</th>
<th>Mean</th>
<th>Std. Dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic business skills</td>
<td>3.3299</td>
<td>0.5843</td>
</tr>
<tr>
<td>Capital investment decisions</td>
<td>3.5464</td>
<td>0.7876</td>
</tr>
<tr>
<td>Business risk management</td>
<td>3.5361</td>
<td>0.8262</td>
</tr>
<tr>
<td>MFIs has contributed in fuelling growth of my Enterprise</td>
<td>3.6804</td>
<td>0.8492</td>
</tr>
<tr>
<td>My Enterprises has been stable and growing without MFIs contributions</td>
<td>3.4845</td>
<td>0.7548</td>
</tr>
<tr>
<td>MFIs credit facilities are accessible</td>
<td>3.8454</td>
<td>0.6889</td>
</tr>
</tbody>
</table>

Source: Research Data

4.4 Correlation Analysis

Correlation analysis was used to establish the relationship between the study variables and results presented in table 4.4 below. Loans received were found to be negatively related to SMEs growth with a coefficient of correlation of -0.5918. This means that an increase in the loans received would result in the decrease in growth of the SMEs. This could be due to the high financing costs and negative effect of loan repayment of firm’s cash flow.

Savings and number of training had positive and significant relationship with the SME growth with coefficient of correlation of 0.7783 and 0.7671. This shows that the SMEs management had benefited from the MFIs services (namely training and savings) through
enhancement of financial and business skills hence contributing to the growth and stability of the SMEs. The findings are in line with Bett (2014) who also established a positive relationship between microfinance services have and growth of the SMEs.

Legal composition on the other hand had a positive but insignificant relationship with SME growth with a coefficient of correlation of 0.1927. SME industry had also a negative relationship with SME growth with a coefficient of -0.0316.

Table 4.4: Correlation Analysis

<table>
<thead>
<tr>
<th></th>
<th>SME growth</th>
<th>Loan received</th>
<th>Savings</th>
<th>Training</th>
<th>Legal composition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loan received</td>
<td>Pearson Correlation</td>
<td>-0.5918*</td>
<td>1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Savings</td>
<td>Pearson Correlation</td>
<td>0.7783*</td>
<td>0.6539*</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Training</td>
<td>Pearson Correlation</td>
<td>0.7671*</td>
<td>0.7312*</td>
<td>0.9425*</td>
<td>1</td>
</tr>
<tr>
<td>Legal composition</td>
<td>Pearson Correlation</td>
<td>0.1927</td>
<td>0.0265</td>
<td>-0.1772</td>
<td>-0.1023</td>
</tr>
<tr>
<td>Industry</td>
<td>Pearson Correlation</td>
<td>-0.0316</td>
<td>-0.1062</td>
<td>0.0950</td>
<td>0.0652</td>
</tr>
<tr>
<td>N</td>
<td>97</td>
<td>97</td>
<td>97</td>
<td>97</td>
<td>97</td>
</tr>
</tbody>
</table>

* Significant at 95% Confidence Level

Source: Research Data

4.6 Regression Analysis

Multiple regressions were used to determine the combined effect of independent variables (credit finance, savings, trainings, legal formation and industry) on dependent variables (SME growth). The study obtained a coefficient of correlation of 0.7928 as shown in table 4.6 below. This means that the independent variables have strong effect on dependent variables. The coefficient of determination of 0.63 implies that the model obtained accounts for up to 63% of the changes in growth of SMEs.
Table 4.5: Model Summary

<table>
<thead>
<tr>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>0.7928</td>
<td>0.6286</td>
<td>0.6082</td>
<td>0.0079</td>
</tr>
</tbody>
</table>

a. Predictors: (Constant), Industry, Legal composition, loan received, Savings, Training

*Source: Research Data*

The analysis of the variance results are presented in table 4.7 below. The study obtained a p-value of 0.000. Since 0.000 is lesser than 0.05, the model obtained is significant at the 95% confidence level. Therefore, the independent variables have a significant effect on the dependent variable.

Table 4.6: Analysis of Variance

<table>
<thead>
<tr>
<th>Sum of squares</th>
<th>Df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regression</td>
<td>0.0096</td>
<td>5</td>
<td>0.0019</td>
<td>30.8049</td>
</tr>
<tr>
<td>Residual</td>
<td>0.0057</td>
<td>91</td>
<td>0.0001</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>0.0152</td>
<td>96</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a. Predictors: (Constant), Industry, Legal composition, loan received, Savings, Training

*Source: Research Data*

The model coefficients are shown in table 4.8 below. The model coefficients show that savings, training, industry and legal compositions have positive effect on the SMEs growth. The coefficients also show that savings have the highest effect on SME's growth, followed by loans received and finally training. The model developed by the study is $Y= 0.4109 + -0.0108X_1 + 16.9471X_2 + 0.0004X_3+0.0019X_4 +0.0003X_5$; where; $Y$ is SME growth, $X_1$ is the amount of microloan received by the SMEs as a percentage of net assets, $X_2$ is total savings done by the SMEs in microfinance institutions as percentage of net assets, $X_3$ is number of trainings received by SMEs from microfinance institutions per year, $X_4$ is the legal composition of the SME and $X_5$ is the SME industry.
Table 4.7: Model Coefficients

<table>
<thead>
<tr>
<th></th>
<th>Unstandardized Coefficients</th>
<th>Std. Error</th>
<th>Beta</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Constant)</td>
<td>0.4109</td>
<td>0.1306</td>
<td></td>
<td>3.1474</td>
<td>0.0022</td>
</tr>
<tr>
<td>Loan received</td>
<td>-0.0108</td>
<td>0.0091</td>
<td>-0.1162</td>
<td>-1.1876</td>
<td>0.2381</td>
</tr>
<tr>
<td>Savings</td>
<td>16.9471</td>
<td>7.1455</td>
<td>-0.4725</td>
<td>-2.3717</td>
<td>0.0198</td>
</tr>
<tr>
<td>Training</td>
<td>0.0004</td>
<td>0.0004</td>
<td>-0.2288</td>
<td>-1.0572</td>
<td>0.0232</td>
</tr>
<tr>
<td>Legal composition</td>
<td>0.0019</td>
<td>0.0014</td>
<td>0.0888</td>
<td>1.3303</td>
<td>0.0168</td>
</tr>
<tr>
<td>Industry</td>
<td>0.0003</td>
<td>0.0011</td>
<td>0.0166</td>
<td>0.2522</td>
<td>0.8015</td>
</tr>
</tbody>
</table>

a. Dependent Variable: Annual growth in sales

Source: Research Data

4.7 Summary and Interpretation of the Findings

The study sought to determine the effect of Microfinance services on the growth of SMEs in the Nairobi informal settlements. The findings established that SMEs in informal settlements received various microfinance services, namely loans, savings and training. The microfinance services received were found to influence business operational skills such as capital investment and risk managements and thus contributing to the growth and stability of the SMEs with mean of 3.6804 and 3.4536 respectively.

Correlation analysis was used to establish the relationship between the study variables and results. Loans received were found to be negatively related to SMEs growth with a coefficient of correlation of -0.5918. This finding could be explained by finding by Kotir and Odoom (2009), who found that, beneficiaries of micro-credit divert a significant portion of such loans into household consumption albeit with moderate impact on household productivity and welfare and micro-credit had modest impact on rural community development.

Savings and number of training had positive and significant relationship with the SME growth with coefficient of correlation of 0.7783 and 0.7671. The findings were in line with those of Bett (2014) who established a positive relationship between microfinance services have and growth of the SMEs. Legal composition on the other hand had a positive but
insignificant relationship with SME growth with a coefficient of correlation of 0.1927. SME industry had also a negative relationship with SME growth with a coefficient of -0.0316.

The finding that micro finance services lead to growth of SMEs in Nairobi informal settlement was similar to that of Leseyio (2014) who established that the existence of microfinance services had contributed to the development of SMEs with provision of credit increasingly been regarded as an important tool for raising the incomes of youths, mainly by mobilizing resources to more productive uses and made credit more accessible. Also, Ngugi and Kerongo (2014) found that microfinance had positive effects on growth of SMEs.

Multiple regression analysis was used to show the combined effect of independent variables on dependent variable. Multiple regression analysis obtained a coefficient of correlation of 0.7928. The co-efficient of determination of 0.63 implied that the model obtained accounted up to 63% of the changes in growth of SMEs of which the effect was significant. The analysis of variance results indicated a p-value of 0.000 indicating that the relationship between the dependent and independent variables was significant since it was less than 0.05. This finding compared with McKernan (2002) who evaluated three significant microcredit programmes in Bangladesh and discovered that the profit for self-employed activities of households could be increased by programme participation.

The model coefficients showed that savings, training, industry and legal compositions have positive effect on the SMEs growth. The coefficients also show that savings have the highest effect on SME's growth, followed by loans received and finally training. The model developed by the study is $Y= 0.4109 - 0.0108X_1 + 16.9471X_2 + 0.0004X_3 + 0.0019X_4 + 0.0003X_5$; where; $Y$ is SME growth, $X_1$ is the amount of microloan received by the SMEs as a percentage of net assets, $X_2$ is total savings done by the SMEs in microfinance institutions as percentage of net assets, $X_3$ is number of trainings received by SMEs from microfinance institutions per year, $X_4$ is the legal composition of the SME and $X_5$ is the SME industry. The finding compared with Oni, et al., (2012) who found that microfinance services contributed to sustainable growth of SMEs in the country. Further, Goswami (2014) found that the small enterprises were playing an important role in improving the standard of living of the people and transforming the economy of a nation at large.
CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Summary

The study sought to determine the microfinance services offered to SMEs in the informal settlements and their role in the growth and stability of SMEs in the informal settlements. The findings reveal that the SMEs in informal settlements received loans/credit finance, trainings and savings; all of which influenced the growth of SMEs.

The study also sought to establish the effect of microfinance services on the SMEs growth. To achieve this objective, a regression analysis was conducted whereby SME growth was regressed against five predictor variables; savings, trainings, loans offered, legal composition and industry of the SMEs. Data for the variables was obtained through questionnaires from the respondents. The coefficient of correlation of 0.7928 was obtained thus showing a strong positive relationship between the dependent and independent variables. Additionally a coefficient of determination of 0.63 was obtained implying that the model obtained accounted for up to 63% of the changes in growth of SMEs. The regression model was significant at 95% confidence level as a significance level of 0.000 was obtained which is 0.05.

The model coefficients obtained through regression showed that savings, training, industry and legal compositions have positive effect on the SMEs growth. The coefficients also show that savings have the highest effect on SME's growth, followed by loans received and finally training. The model developed by the study is $Y = 0.4109 + -0.0108X_1 + 16.9471X_2 + 0.0004X_3+0.0019X_4 +0.0003X_5$; where; $Y$ is SME growth, $X_1$ is the amount of microloan received by the SMEs as a percentage of net assets, $X_2$ is total savings done by the SMEs in microfinance institutions as percentage of net assets, $X_3$ is number of trainings received by SMEs from microfinance institutions per year, $X_4$ is the legal composition of the SME and $X_5$ is the SME industry.
5.2 Conclusions

Micro finance is perceived as the provision of financial and non-financial services by Micro Finance Institutions to low income groups without tangible collateral but whose activities are linked to income generating ventures. These financial services include savings, credit, payment facilities, remittances and insurance. The non-financial services mainly entail training in micro enterprise investment and business skills. Small and micro enterprises constitute to the majority of businesses in Nairobi County and mostly the informal settlements. In Kenya, SMEs create the highest number of new jobs per year. Kenya is facing an increasing growth of informal settlements in her urban centres. The informal settlements are characterized by large number of small and micro enterprises. Further, in attempt to improve the standards of living in these informal settlements, the government and nongovernmental organizations have been supporting these businesses in form of microfinance.

Based on the study findings, the study concludes that SMEs in Nairobi informal settlements receive microfinance services such as training, loans and savings. The microfinance services have played a great role in enhancing the growth of SMEs through providing finances and business skills. These services are crucial to businesses in informal settlements majority of which are sole proprietorships.

The study also concludes that credit finance used by the micro and small enterprises negatively affect the growth of SMEs. This could be due to the high rates of interest on the loans received and negative effect of regular cash out flows. However, it would be hard for the SMEs to receive other services without the micro finance institutions offering loans since they are also profit making entities.

The study also concludes that training and saving services have positive effect on growth of SMEs. This could be due to the fact that trainings equip the SMEs management with business and financial skills which are crucial to making business decisions. Savings services on the other hand promote prudent financial management practices and avails finances to the firms in the future.

Finally, the study concludes that there exists a strong positive relationship between microfinance services combined and growth of the firms. Microfinance services account for
over 60% of the changes in growth of the firm. This is irrespective of the fact that credit finance alone has negative effect on growth of the firm.

5.3 Recommendations to Policy and Practice
Based on the study findings, the study makes the following policy. First, micro finance serves have high positive effect on growth of SMEs. Hence, the study recommends that the government to develop mechanisms to encourage micro finance institutions outreach. This will ensure that more SMEs have reach to microfinance services and hence their growth will be stimulated. The study also recommends that SMEs managers and owners to seek the services of microfinance institutions as these will go a long way in ensuring SMEs growth.

The study also found that credit finance has negative effect on growth of the SMEs. This is due to the high interest rates charged by the microfinance institutions. The study therefore recommends that microfinance institutions to reduce the interest rates charged on credit advanced to the SMEs. Micro finance institutions can also seek the help of nongovernmental organizations and offer grants to SMEs. This will avoid the negative effect the cash outflows have on SMEs growth.

There is need to provide an enabling environment for SMEs to grow and thrive, therefore there is a need to develop strategies to enhance increased access to microfinance services by SMEs from commercial banks and microfinance institutions. It is important for the government to set up policies that will ease microfinance credit to SMEs. These policies should be in line with both the owners of SMEs and financial institutions in order to prevent putting hindrances to potential and credit worthy customers who seek to expand or start up a business. This will create a window for growth and development of the economy as a result of more job opportunities and increased flow of money circulation in the economy.

Financial institutions should ensure that they sensitize the owners of SMEs on best financial management practices. This will help the owners of SMEs to utilize borrowed money efficiently. Lending institutions should also advise borrowers on how to appraise their projects for viability to ensure that they make wise decisions when investing in projects. The study recommends the Central Bank to set up policies and procedures to prevent barriers that inhibit potential owners and managers of SMEs from accessing credit facilities from commercial banks and micro finance institutions. This will create a conducive environment
for SMEs to growth and expand. It will also open up opportunities for jobs and this will enhance economic growth.

5.4 Limitations of the Study

The study was faced by a number of limitations relating to the methodology and the scope. First, the study only concentrated on SMEs in Nairobi's informal settlements. These firms cannot be a representative of all SMEs in Kenya or other localities. In addition the sample size of 100 SMEs was small but manageable with the resources and time available. However to make better conclusions, increasing the number of would make the findings more representative and enable generalization of findings.

The study also targeted small and micro enterprises in informal settlements. Majority of the firms do not keep complete books of accounts and a number of information sources had to be relied upon. While every small business-owner has the best intentions to maintain accurate and complete accounting records, sometimes accidents happen. Incomplete accounting records can cause problems when reporting. The financial statement obtained from the documents was also not audited and hence its accuracy could not be verified beyond reasonable doubt.

Additionally, the respondents were reluctant to provide information. This was due to confidentiality fears on the provided information. However, the researcher made efforts to assure the respondents on the confidentiality in use of information provided and that it was entirely for only academic use. Also due to strict internal policies on sharing financial information, the researcher had to do follow ups and seek such permission from the SMEs top management.

This study was carried out within a limited time frame and resources which constrained the scope and depth of the study. This necessitated the adoption of a sample design hence these findings cannot be used to make generalizations on the effect of microfinance services on growth of SMEs.
5.5 Suggestions for Further Research

This study used a small sample of SMEs to represent the SMEs in the Nairobi informal settlement areas due to inadequate resources and time limitations. With availability of more resources, further research is recommended using a large sample since the study only used 100 SMEs which cannot be representative of all SMEs in Nairobi informal settlement. A similar study is also recommended in other regions of the country. This will ensure that the results can be generalized.

This study was done at one point in time and was faced by inability to verify the accuracy of the information obtained. To overcome this, a similar study is recommended where the data can be collected over five years. The researcher can provide the SMEs with the records to use in recording the data. The data should be maintained on a daily basis and the researcher reviewing the same on monthly basis. This will ensure that data collected is accurate and reliable.

For the small and micro enterprises sector to grow small businesses need to link with the rest of the economy. Most of these businesses are so small that creating a link seems almost impossible. Further research should be done in this area to establish the best way of linking small and micro businesses with large companies in the economy.

The study concentrated on the SMEs. It is important to carry out similar study among large enterprises in order to find out the effect of micro finance services on performance of these firms. Future research should also focus on the different aspects of micro financing on the performance of large firms.
REFERENCES


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APPENDICES

Appendix I: Questionnaire
This purpose of this questionnaire is to collect data for purely academic purposes. The study seeks to determine the effect of microfinance services on growth of small and micro enterprises in Nairobi’s Informal Settlements. All information will be treated as confidential. Please do not put any form of identification on this questionnaire.

SECTION A: BACKGROUND INFORMATION

1. Please indicate the location from which you operate
   - Kibera [ ]
   - Mathare slums [ ]
   - Korogocho [ ]
   - Mukuru Kwa Njenga [ ]

2. What is your SME business sector
   - 1: Manufacturing [ ]
   - 2: Trade [ ]
   - 3: Service [ ]

3. How long has your firm been in operation?
   - Less than 2 yrs [ ]
   - 2–4 yrs [ ]
   - 5-8 yrs [ ]
   - 8-10 yrs [ ]
   - More than 10 yrs [ ]
   Please specify the exact years as at December 2014.................................

4. What position are you holding currently?
   - Owner [ ]
   - Partner [ ]
   - Line Manager [ ]
   - Director [ ]
   - Other Staff [ ]
5. SME legal formation
   1. Sole proprietorship [ ]
   2. Partnership [ ]
   3. Limited company [ ]

6. Current SME number of employees
   Below 5 [ ]
   6-10 [ ]
   11-20 [ ]
   21-50 [ ]
   Over 50 [ ]

SECTION B: MICROFINANCE SERVICES AND SME GROWTH

7. Which of the following services does your firm receive from microfinance institutions:
   Loans/credit finance [ ]
   Business advice/trainings [ ]
   Savings [ ]
   Others [ ]
   If others, please list them…………………………………………………………………

8. In a scale of 1-5, rate the below in respect to training if any by MFIs. Note 1 =Less favourable; 2=moderately satisfactory;3= satisfactory;4=Very satisfactory and 5=Most satisfactory.

<table>
<thead>
<tr>
<th>Service</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic business skills</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capital investment decisions</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Business risk management</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>MFIs has contributed in fuelling growth of my Enterprise</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>My Enterprises has been stable and growing without MFIs contributions</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>MFIs credit facilities are accessible</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
9. Please indicate the following in relation to your firm as in the below table.

<table>
<thead>
<tr>
<th>Year</th>
<th>2014 %</th>
<th>2013 %</th>
<th>2012 %</th>
<th>2011 %</th>
<th>2010 %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage annual growth in sales</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Amount of microloan received as a percentage of net assets</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Amount of saving mobilized through MFI as a percentage of net assets</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Number of training offered</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

END

*Thank you for your time*