

**THE EFFECT OF MICRO FINANCE LOANS ON THE
FINANCIAL PERFORMANCE OF SMALL MEDIUM
ENTERPRISES IN NAIROBI COUNTY**

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DECLARATION

I declare that this Research Project is my original work and has not been submitted for examination in any other university or institution of higher learning.

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D63/71095/2014

This Research Project has been submitted for examination with my approval as the University Supervisor

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DEDICATION

This project is dedicated to my parents especially my father who encouraged me a lot and supported me financially and also to my relatives, friends& classmates whom they encouraged and supported me during the entire period of my study. Your efforts have deeply been appreciated. I thank you all.

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LIST OF ABBREVIATIONS

ANOVA	Analysis of Variance Technique
CBK	Central Bank of Kenya
GDP	Gross Domestic Product
KNBS	Kenya National Bureau of Statistics
MFI	Management Financial Intuitions
MSEs	Medium and Small Enterprises
MSMEs	Micro, Small and Medium Enterprises
NGOs	Non- Governmental Organizations
ROA	Return on Assets
ROE	Return on Equity
ROI	Return on Investment
SMEs	Small and Medium Enterprises
SPSS	Statistical Package for the Social Sciences

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ABSTRACT

To examine the effect of micro finance loans on the financial performance of small medium enterprises in Nairobi County. The study was descriptive in nature. The population for this study was the SMEs operating in Nairobi County. The target population was grouped based on 17 constituencies in Nairobi County: Westlands, Dagoretti North, Dagoretti South, Langata, Kibra, Roysambu, Kasarani, Ruaraka, Embakasi South, Embakasi North, Embakasi Central, Embakasi East, Embakasi West, Makadara, Kamukunji, Starehe and Mathare. According to Public Procurement Oversight, there were an estimated 5,596 SMEs operating in Nairobi County of which 526 SMEs belonged to persons with disabilities, 939 SMEs belonged to women, 18 were general SMEs while the largest chunk of 4538 SMEs belonged to the youths. According to the table the sample population should be 357. A stratified random sampling technique was used in this study. Random sampling employed to pick SMEs for the sample. This study used a questionnaire in data collection. The study provided two types of data analysis; namely descriptive analysis and inferential analysis. The analysis entails gathering of data from different sources, their review and analysis to form a deduction. This study used linear regression analysis model and so this study will use the analytical software in data analysis. Among the software that was used was Statistical Package for the Social Science version 21.0 (SPSS) and advanced excel for analysis. The linear regression model was applicable since it allowed simultaneous investigation of the correlations among different variables. The study established that the type of business which most of the SME in Nairobi County engage in is retailers. The study also found that microfinance loan influence financial performance in SME's in Nairobi County to a very great extent. The data findings analyzed also shows that taking all other independent variables at zero, a unit increase in Microfinance loans will lead to a 0.852 increase in financial performance of the SME; a unit increase in age of the SME will lead to a 0.643 of the SME increase in financial performance, while a unit increase in credit accessibility will lead to a 0.473 increase in financial performance of the SME. At 5% level of significance and 95% level of confidence, the study found out that Microfinance loans, age of the SME, and credit accessibility were all significant in financial performance of the SME. The study concludes that the type of business which most of the SME in Nairobi County engage in is retailers. The study also concludes that microfinance loan influence financial performance in SME's in Nairobi County to a very great extent. Based on the key findings, the study made the following recommendations. Microfinance Institutions should enhance training of their clients on the entrepreneurial skills so as to enhance their skills as a large proportion of the respondents were found to be certificate holders of high school graduates hence they lacked the necessary business management skills. The study established that high interest rates and repayment period inhibit some of the SME's in Nairobi County from accessing microfinance loans to a very great extent. The study also recommends the MFIs carry out sensitization campaigns on the need to save among the traders.

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Despite the rapid growth that it has experienced, one of the challenges Kenya is facing today is poverty reduction. To address this poverty delinquent, several programs have been initiated and implemented in the country. Among these initiatives is microfinance, earlier known as microcredit. The concept of micro lending was principally introduced more than three decades ago in Bangladesh by Nobel Peace Prize winner Professor Muhammad Yunus. He started Grameen Bank with the aim of reducing poverty by providing small loans to the country's rural poor who had little or no access to capital from financial institutions (Yunus, 1999). A key feature of microfinance has been the targeting of women on the grounds that, compared to men, they perform better as clients of microfinance institutions and that their participation has more desirable development outcomes. In the 21st century, microfinance banks do not only provide credit to the poor, but also a myriad of other services including savings, insurance, remittances and non-financial services such as financial literacy training and skills development programmes.

The development of small firms is generally agreed to be a key ingredient in poverty reduction (World Bank, 2000). Microfinance has one of its visions being to steer the growth of micro enterprises. Among many challenges facing small and medium enterprises (SMEs) is lack of access to finances. In Kenya, credit facilities to SMEs are in the form of loans or debt financing offered by banks, which provide for their growth capital. The obstacles to SMEs in accessing credit facilities is the perception by banks that offering loans to SMEs is risky, inability of the SME operators to fulfill

the collateral requirements; lack of a guarantee scheme to back up banks financing SMEs; high cost of screening and administering small loans spread over big areas and inability of borrowers to prepare and present business plans that meet bank's requirements (MSME BILL, 2009).

Some banks and micro finance establishments in Kenya, despite all the perceptions, have taken a chance on SMEs offered them credit facilities. They have perceived SMEs as a critical ingredient for economic growth and development because with the increasing unemployment rates especially among the youths, SMEs makes significant contribution toward job creation and provision of low cost goods and services. This has largely contributed towards the vision 2030 specifically the economic pillar. With this great improvement, there is still no specific estimation of the effect the micro finance loans have on the profitability and general financial performance of SMEs. This is the area this study aims to concentrate on.

1.1.1 Micro Finance Loans

A Microfinance Loan is a formal arrangement in which a bank gives money to a borrower who in turn agrees to return it usually along with interest at some predetermined future point(s) in time. Loan facilities have been there in many African countries and can be traced back before independence. The colonial government did not provide credit facilities to the African people, and hence the informal credit groups such as merry go rounds were formed within the societies in rural areas and clan levels. In Kenya the, the idea of Micro Credit during the 1970's government agencies were set up as and their main responsibility was to provide credit to those who had no previous access to credit facilities (Kabiru, 2002).

Microfinance is a source of financial services for entrepreneurs and small and medium enterprises which have difficulties meeting the strict preconditions of access to bank credit especially collateral like title deeds and log books. Microfinance has proved this bank stern concept to be wrong as they go ahead and target the SMEs who are considered risky with no collateral but the repayment rate turns to be positive. There are two main mechanisms used by micro finance banks to these loans to clients without collateral security. First, there are group based models where several entrepreneurs come together to apply for loans as a group and so as each other's watch guards towards repayment. Secondly, there's relationship based banking for individual entrepreneurs and small businesses.

Microfinance establishments have improved the living standards of low income earners, small scale industries and small manufacturing plants owners and as a result, lower and middle class people are more attracted everyday towards microfinance services. Microfinance has also made necessary and user friendly repayment options to repay the loan well in time and to take a fresh loan after the closure of the first one. Documentation and the access to microfinance is the other reason why it has become so successful. While availing any loan from the microfinance, the documentation process is least and people can take a loan with the minimum required documentation (Kamau & Kalio 2012).

1.1.2 Financial Performance

Moullin (2003) defines financial performance as how well the firm is able to manage it operations through delivery to clients and shareholders. Achrol and Etzel (2003) concur with Moullin (2003) by defining financial performance as the extent to which an organization can accomplish its goals. Financial performance is normally used in

tracking and reviewing the progress of SME's and its strategic goals and plans. The definition from the two authors' perspectives examines the manner in which SMEs should appear to its customers to attain its vision. The definition identifies market and customer segments where the entity would compete, as well as the expected performance in the targeted segment.

For the attainment of the goals, missions and objectives of any SME is dependent on constant evaluation and assessment to determine whether its operations are on the right course. There are various methods that can be used to measure financial performance of an SME. Different SMEs have different structures and goals and so differences in methods used to measure their financial performances. Among the measures include profitability, liquidity, and operating & financial ratios. Profitability is measures as return on investment or return on assets. Operating and financial ratios are normally employed in measuring the financial condition and performance of an organization (Ogilo, 2012). Among the ratios used is profitability ratio. Hermann (2008) asserts that when determining an organization's profitability, the analysis should concentrate on evaluating its earnings with respect to its assets, owner's investment and or share values.

There are other various tools used to measure the financial performance of business. These include Return on Investment (ROI), Residual Income (RI), Earning per Share (EPS), Dividend yield (DI), Earning Ratio, growth in sales, market capitalization and others (Barbosa and Louri, 2005).

Unger and Rosenbusch (2007) supports financial performance of a firm as essential dependent variable in an organization. In this research, the financial performance of the selected SMEs will be determined using Return on Asset (ROA). This is because

ROA considers the Return on Investment (ROI) and illustrates the efficiency of an SME in making profits based on its investments and assets (Hermann, 2008). According to Caudle (2008), this perspective examines the processes in which the business entity should excel so as to satisfy the customers and shareholders.

1.1.3 The Effect of Micro Finance Loans on Financial Performance

Microfinance loan is a crucial tool for economic empowerment to individuals especially the women and youths in Kenya. The microcredit industry has supported more than 3 million Small and Medium Enterprises for close three decades. Existing literature on the growth MSEs indicate that many SMEs fail to expand due to limited financial resources, poor managements, use of outdated technologies, stiff competitions from bigger firms, poor management of account receivables, unfavorable government policies among others. Poor access to loans and limited finance are stated as the main causes limiting the growth of micro and small enterprises (Yaron, 1997). However, Microfinance establishments have a significant role in increasing participation in SMEs through financing hence contribution to economic growth and development of the nation.

The findings on the statistics in the study by Muiruri (2014) demonstrate that MFIs offer services to customers who are of the low income earning level and the disadvantaged, majorly women, persons with disabilities and youths to start up or expand SMEs and this has contributed to economic growth which has been rapid over the years. Asemelash (2002) confirmed a positive impact of microfinance on beneficiaries as compared to non-beneficiaries. He showed that microfinance has impacted positively income, asset building, and access to schools and medical facilities. However credit alone can't automatically lead to increased financial

performance. Madole (2013) established that, age or experience of the SMEs owners, and, credit accessibility influence the access of credit and that once accessed, there is need for training on best investment decisions or maintenance of increased profits. The study concluded most of the small businesses depend on loan for business capital growth which plays a very crucial role to promote small business financial health.

1.1.4 Small Medium Enterprises in Nairobi County

SMEs are sometimes referred to as Micro, Small and Medium Enterprises (MSMEs) cover nonfarm activities such as manufacturing, mining, commerce and services. There are different yardsticks of categorizing SMEs. Commonly used yardsticks are total number of employees, total investment and sales turnover. In the context of Kenya, MSMEs are those enterprises engaging less than 10 employees, in most cases family members, with an annual turnover not exceeding Kshs. 500,000. Majority of MSMEs fall under the informal sector. Small enterprises are formalized undertakings engaging more than 10 but less than 50 employees, with an annual turnover between Kshs. 500,000 to Kshs. 5 million. Medium enterprises employ more than 50 but less than 100 employees and have an annual turnover between Kshs. 5 million to Kshs. 800 million (MSME BILL, 2009).

Micro and Small Enterprises (MSE) known as JuaKali are the biggest informal employer in Kenya and accounts for 10 million and 8.3 million of this number are in the informal sector. It also continues to employ more each year at an average rate of about two percent. Small and Medium-Sized Enterprises (SMEs) play a major role in economic development through employment creation and income generation (Muiruri, 2014). In the Juakali sector, practical skills are being developed at low cost

and with financial support; various types of small scale technologies can be developed for labor intensive enterprises that could absorb hundreds of young job seekers.

However, those who run the businesses in this sector lack adequate business skills that could be mainly attributed to low levels of education. The producer must be a skilled business man or woman who must be able to handle all aspects of the business like selling, marketing, and wielding financial controls. Other challenges that have continued to have a negative impact on the growth of SMEs in Kenya include, but may not be limited to, poor infrastructure, insecurity and high cost of energy.

1.2 Research Problem

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 microfinance services within the reach of poor people and MSEs that have not benefited from the conventional formal financial system, growth and expansion of SMEs sector had not shown any sign of growth and expansion. Poverty is a concept that applies to all humans and more seriously to people in the developing world. The deadly effect of poverty on the poor necessitated a worldwide research into ways of reducing its impact. An important tool in fighting poverty is microfinance which has gained prominence over the last few decades in countries hardly hit by the menace(Wanambisi,2013).

Studies have shown that microfinance has produced certain successes in poverty reduction and increased performance of SMEs. Adama and Agbim (2015), found out that micro-credit has significant effect on self-employment, education, training and skills acquisition, and economic empowerment. Wanambisi (2013) found out that the amount of loans is significantly and positively related with performance of MSEs in

Kitale Municipality. He found that access to microcredit significantly associated with sales, net profit, number of paid workers and liabilities thus access to microcredit had positive effects on the growth of enterprises. On the contrary, other scholars that microfinance has not had the much hyped impact.

According to Ouma and Rambo (2013) microfinance lending policies were not responsive to financing needs of clients and to changes in the business environment. This undermined the potential of funded enterprises to achieve sustainable growth. Kimaru (2014) discovered that MFIs face challenges in service delivery such as: banks relying on personal profiles and track records in reviewing application. Bowen and Makarius (2009) shows that over 50% SMEs continue to have a deteriorating performance with 3 in every 5 SMEs falling within the months of establishment.

Despite the growth of microfinance in the finance sector, recent studies have continued to report mixed findings on the effect of microfinance loans on financial performance of the firm. Some report a positive relationship but also note challenges in delivery of the loan facilities. Others report a deteriorating performance of SMEs because loan comes with a price. This then lead to the question of the effectiveness of the role of microfinance loans in promoting the financial performance of SMEs. This has motivated by the need to fill-up the academic gap on contribution of microfinance loan by explicitly answering the question: What is the effect of micro finance loans on the financial performance of small medium enterprises in Nairobi County?

1.3 Objective of Study

To examine the effect of micro finance loans on the financial performance of small medium enterprises in Nairobi County.

1.4 Value of Study

The study will assist the government, especially in Nairobi County, in developing policy frameworks to alleviate financial challenges that Small and Medium enterprises face. The policies will be helpful in enhancing the performances of SMEs. The state and the local authority in Nairobi will also use the research outcomes in pursuance of strategies towards the development of the SMEs sector and this stimulates economic growth. The research outcome will help managers use appropriate financial innovations that will steer SME to improve financial performance.

The study will help the manager of respective SMEs to improve their intellectual understandings of various factors affecting financial performance of their SMEs. This will help them understand the challenges faced by other related SMEs and thus helping the managers improve on their performances. The study will thus be essential as it will highlight the risk mitigation strategies used by the SMEs and so assist in improving their products.

The study will contribute to the existing knowledge on the financial factors affecting SMEs. The information that will be obtained from the analysis will help future researchers. It will provide a platform for discussions amongst scholars on the effect of microfinance loans and provides a basis for further research.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter will deliberate the theories, factors affecting financial performance and empirical studies both internationally and locally related to microfinance loans and performance.

2.2 Theoretical Review

This section explains the theoretical foundations of microfinance loans and performance. Three theories are discussed namely: Study is grounded on Financial Liberalization Theory, Game Theory of Microfinance and Financial Sustainability Theory.

2.2.1 Financial Liberalization Theory

Published in 1966, the genesis of financial liberalization theory dates back to the seminal paper of McKinnon (1973) and Shaw (1973) sometimes referred to as McKinnon and Shaw or Financial Repression Theory. The theory posits that there exist two way of evaluating the connection between finance and development. One of the ways is “demand-following” and takes place when finance deepens as economy grows (Ahmed, Abdullahi, Islamand Sardar 2009); the other is “supply leading” and takes suppose growth of firm is pursuant to its financial expansion. Reinhart, Ostry, Jonathan and Carmen (2003) point out that financial liberalization can improve the rate of growth as interest rates move towards market average value, and resources are properly utilized. Consequently, removing controls on interest rates and letting interest rise could inspire increased saving rates. Additionally, with the supposition

that increased savings leads to reduced interest rates, increased rates are expected to raise financial intermediation (Reinhart et al., 2003). Strictly with the above assumptions, it is probable that financial liberalization yields increased savings which eventually increases economic development through alterations in quality (through allowing efficient resource locations) and investment quality.

The adoption of policies of financial liberalization will lead to improved productivity and boost growth in the economy. Ahmed et al., (2009) asserts that the strategies lead to increased propensity to save and this increased savings to investors and in turn lowers the interest rates. The proposition here is that interest rates are retained below the market rates under the repressed financial system, with the purpose to achieve sufficient capital for SMEs. The result is that there will be reduced investment and savings leading to increased disparity amid borrowing and SME's rates, and this can lead to low business. However, Ahmed et al. (2009) state that financial liberalization is expected to rectify the aforementioned disparities by letting market determination of all SME's interest rates and stabilization of inflation.

This research considers this theory essential since it also leads to increased allocative efficiency and improved performance of the investment. It is through financial liberalization that SMEs can institute various mechanism to ensure that there is sufficient flow of credits to borrows and creditors (SMEs) get optimal value for their investments (Ahmed et al., 2009). Among the measures include quantifiable credit strategies, the concessional interest rate to specific SMEs, restricted liquidities and cash reserve ratios. Financial liberalization also entails removing all non-market strategies of interest rate control, leaving market system pricing and fund allocations. The economic reforms enacted through financial liberalization improve the

investment effectiveness via the efficient use of available resources, and this eventually boosts the performance of SMEs.

2.2.2 Game Theory of Microfinance

According to Avinash Dixit and Nalebuff (2008) the pioneer of game theory was Princeton Mathematician called Neumann. In its starting stages, the emphasis was placed on games of pure conflict. The contrary was regarded as a cooperative one and the participants were required to select and jointly enact their own actions. However, Avinash Dixit Nalebuff (2008) asserts that recent research has discovered game theory is not based on cooperation. According to the two authors, these games, the participants are solely responsible for their actions which they take actions individually, but their connections to other members in the group involve elements of both competition and cooperation.

The game theory of finance supports the idea of group lending among small, medium enterprises. According to this theory, Mbithe (2013) asserts that various mechanisms depend on group borrowers to cooperatively regulate and enforce contracts themselves. This theory is based on Grameen lending model that is founded on group peer pressure in which credits are given to groups of between four to seven members. The member of a particular group jointly guarantee their fellow members' loan settlements and access to succeeding credit facilities base on successful repayments by all members of the group (Mbithe, 2013). The lending model supports weekly repayments. The model assumes that the team is efficient in discouraging loan defaulters as evinced by the low rates of defaulters in companies like Grameen Bank, which employ this model.

The game theory is used in this research since it has contributed to wider advantages due to its mutual trust arrangement at the expense of the entire group. Game theory is used in intuiting how group borrowers play microfinance game with creditors for example SMEs. From the theoretical point of view, the starting positive outcome from group lending experience is perplexing. Yunus (1998) describes group lending as defenseless from danger moral problems. Particular, he highlights the possibility of the existence of free-riding by particular individuals and possibility of collusion behavior by the entire group against the creditor. Additionally, Ledgewood (1999) also states that the group typically becomes a building block for the bigger social network. Though Grubes (2005) contradicts the theory to have a lot of riding and collisions, and various efficiencies, the fact that the theory has been successfully applied in different organizations makes it reliable and thus its applicability.

2.2.3 Financial Sustainability Theory

Sustainability refers to operations that build and maintain sustainable economic, social and natural environments. Thus, the concept of sustainability links to the economic performance of an organization, to the health of employees and to the stock of natural resources in the long term (Dunphyet, 2003). SME that upholds these three principles is termed sustainable organization. Economic sustainability implies the application of various organizational strategies that lead to utilization of available resources to the best advantage. This is done in the most efficient responsible way in order to ensure long-term benefits (Grant, 2009).

Financial sustainability of SMEs and organizations in other sectors is doubtless the key dimensions of microfinance sustainability. Due to its significance in microeconomic performance, most often, in microfinance the term “financial

sustainability” has been used to define organizational sustainability. It can be measured using two stages: financial self-sufficiency and operational sustainability of the SME. Operational Sustainability is the ability for an organization to support all its operations using the generated income (Thapa, Chalmers, Taylor and Conroy,1992). Self-sufficient is the ability for the organization to cater for their individual generated income, financing and operating and other forms of subsidy valued at market price. That is, its ability to cover its costs suppose its activities are not funded and suppose it raised funds at commercial rates (Balkenhol, 2007). The ability for an organization to sustain itself in a long-term is essential for SMEs to reach their clientele and also to be able to have sufficient funds to take care of operational costs (Wells, 2010). Even though SMEs should have the objective to reach poverty-stricken and poor communities, the ability for them to remain sustainable should be their first priority. The sustainability for the SMEs has external and internal implications.

The financial sustainability theory is applicable in this research in two key areas. The first area is to help the researcher focus on human sustainability (Dunphy, 2003). An SME can achieve this by setting up a system for providing continuous services to the target group. Secondly, the theory is applicable in manifesting principles of sustainability by focusing on the economic sustainability of SME (Dunphy, 2003). This involves ensuring that SME’s capital used as inputs are economically recycled. SME upholding this principle becomes an active promoter of ecological sustainability values.

2.3 Factors Affecting Financial Performance

This section explains the factors that affect performance citing the evidence on the proposed factors. The factors include microfinance loans, managerial skills, lending rates, age of the firm, credit accessibility and gross domestic products.

2.3.1 Microfinance Loans

Madole (2013) stated that bank loan plays a very crucial role to promote small business growth. His findings were that the amount of loans is significantly and positively related with performance of MSEs. Therefore, the government and MFIs should enhance the out-reach of microfinance loans through creating awareness of the activities and operations to SMEs especially those in rural and semi-urban areas that are yet to appreciate the benefits of the scheme. Wanambisi(2013) also recommended that amount of loan given by MFIs to MSEs should be increased to enable the MSEs grow to medium scale enterprises.

2.3.2 Managerial Skills

Management style plays a key role in the success of every organization. Based on their leadership characteristics, business leaders use different activities and management tools to improve financial performance. Bowen and Makarius (2009) in their research concluded that business success is a consequence of embracing a mix of managerial strategies.

2.3.3 Lending Rates

Accessing low interest credit is considered to be an important factor in increasing the performance of SMEs. Bourke (1989) reports that the effect of credit risk on

profitability appears clearly negative. Kamau and Kalio (2012) proposed that access to low interest credit further increases SME's risk-bearing abilities; improve risk-coping strategies and enables consumption smoothing over time. Study by further indicated that the level of interest rates charged on the loans by the MFIs have negative correlation with the parameters of business performance. High interest rates do not reduce the financial cost, improve cash flow as well as increase profitability of the SMEs.

2.3.4 Age of a Firm

Age of a firm refers to the years a business has been in operation. Madole (2013) found out that collateral, age or experience of the SMEs owners, and, credit accessibility influence the access of credit and hence affects performance of firms. Corporate aging could occur for reasons, consistent with cementation of organizational rigidities, costs rise, margins thin, growth slows, assets become obsolete, and investment and R&D activities decline as firms get older. Aging also seems to advance the diffusion of rent-seeking behavior: corporate governance worsens and CEO pay goes up. Overall, firms seem to face a serious aging problem.

2.3.5 Credit Accessibility

Access to credit enables Small and Medium enterprises to enhance their financial performance. The main objective of microcredit is to improve the performance of SMEs as a result of better access to small loans that are not offered by the formal financial institutions. It is argued that insufficient access to credit by the poor just below or just above the poverty line may have negative consequences for SMEs and overall welfare (Kamau & Kalio, 2012).

2.3.6 Gross Domestic Product

Gross Domestic Product is an indicator of size of an economy in terms of the total dollar value of all goods and services produced over a specific time period. It is an indicator used to gauge the health of a country's economy. Ovamba (2014) asserts that on the relationship between macroeconomic factors and bank profitability had results indicating that macroeconomic factors (real GDP, inflation and exchange rate) have a significant effect on financial performance of SMEs in Kenya.

2.4 Empirical Review

The empirical review discusses the international and local studies on the microfinance loans and financial performance.

2.4.1 International Evidence

Madole (2013) aimed to examine the impact of microfinance credit on the performance of SMEs in Tanzania, specifically in Morogoro Municipal. The research design employed was a case study. Data were collected from 100 respondents. Simple random and purposive sampling techniques were used to arrive at 80 customers as well as 20 Bank staff respectively. Data were collected using interviews, questionnaires, observation and documentary review. Data were analyzed using descriptive statistics (frequencies and percentages) using computer package called Statistical Package of Social Science (SPSS) version 20.0. Results showed that through the credit obtained from a bank in Morogoro, SMEs have been able to improve businesses in term of: increased business profit, increased employees, increased sales turnover, increased business diversification, increased business capital and assets as well as reduction of poverty among customers surveyed. Result also

shows that collateral, age or experience of the SMEs owners, and, credit accessibility influence the access of credit. The study concluded most of the small businesses depend on bank loan for business capital growth. Bank loan plays a very crucial role to promote small business growth.

Wanambisi(2013) examined the effects of microfinance institutions lending on micro and small enterprises performance within Kitale Municipality. This study adopted a descriptive survey research design and the target population was 1,200 MSEs which were registered within Kitale Municipality and had operated for at least three years. The target population was stratified into homogeneous categories as wholesalers, retailers, restaurants and service delivery. A sample of 120 MSEs was used. Data was collected using a semi-structured questionnaire. Completed questionnaires were verified and coded by the researcher in a computerized package called SPSS then analyzed and summarized in frequency tables, pie charts and figures. The association between microfinance lending and MSE performance variables was established through Chi square and correlation tests at 95% significance level. A multivariate logistic regression was used for significant bivariate variables. The findings were that the amount of loans is significantly and positively related with performance of MSEs in Kitale Municipality.

Chibole (2014) seeks to investigate the following research question: how does capital Microfinance loans, liquidity and ownership affect growth of medium enterprises in Kenya? The study used cross-sectional descriptive survey. The target population was 311 drawn from medium enterprises located in Nairobi Central Business District (NCBD). The study used stratified random sampling and involved taking 20% of the target population giving a respondent base of 62 respondents. Data for the study was

collected using the questionnaires and analyzed using descriptive and regression statistics with the aid of Statistical Package for Social Sciences (SPSS 21.0). Findings of the study indicated that capital structure, financial liquidity and ownership structure affect growth of medium enterprises in Kenya. The study recommended that enterprises need to avoid high Microfinance loans ratios which may result in high transaction costs resulting in a weakened position to pay higher dividends; for SMEs to encourage institutions to invest in their enterprises.

Boateng (2015) ascertained the impact of microfinance on poverty reduction in Ghana. The study employed economic and social variables such as individual income, household growth, access to education, housing and participation in social and religious activities as benchmarks for measuring the impact. Questionnaires were administered to 60 customers and beneficiaries of microfinance products of two major microfinance institutions in Ghana: Opportunity International Savings and Loans Ltd. and Sinapi Aba Savings and Loans Company Ltd. The study found a positive relationship between microfinance and the benchmark variables and recommended training for beneficiaries to ensure efficient use of funds and creation of sound political and economic environments so microenterprises can thrive.

Adama and Agbim (2015) set out to assess the relationship between micro-credit, and self-employment, education, training and skills acquisition, and economic empowerment. Regression statistical method was employed to analyze the generated data. The study adopted survey research design and systematic sampling technique to select the elements that completed the research questionnaire. It was found that micro-credit has significant effect on self-employment, education, training and skills acquisition, and economic empowerment. They went ahead and recommended that

more awareness on the relevance of micro-credit to self-employment, education, training and skills acquisition, and economic empowerment should be created and that microfinance institutions should be encouraged to provide women entrepreneurs.

2.4.2 Local Evidence

Ouma and Rambo (2013) assessed the effect of access to microcredit services on the growth of women-owned enterprises within the Central Business District of Kisumu City. Primary data was sourced from 190 women entrepreneurs. The study found that access to microcredit significantly associated with sales, net profit, number of paid workers and liabilities. Thus, access to microcredit had positive effects on the growth of women-owned enterprises. In addition, microfinance lending policies were not responsive to financing needs of women and to changes in the business environment. This undermined the potential of funded enterprises to achieve sustainable growth. The study recommends the need to review the financial institution's lending policies, increase the amount of microcredit funds and encourage other actors to finance women-owned enterprises.

Kimaru (2014) examined the effects of micro finance institutions activities on the performance of small and medium scale enterprises owned by women in Mogotio district. The target population was 626 SMEs in Mogotio district by May 2013. Stratified random sampling was used to select the SMEs which were beneficiaries of 9 existing MFI's in the district. Simple random sampling technique was used to select representative sample from every strata. A sample size of 190 respondents, (at least 30% of the target population) was involved in the research study. Questionnaires were used to collection quantitative data. The instruments of data collection were divided as per the variables and objectives to ensure that the content would be comprehensive

and representative. Data was presented using frequency tables, pie-charts and histograms. Data analysis was done using both descriptive and inferential statistics. Specifically, chi-square, ANOVA, regression and correlation analysis was used with the aid of statistical package for social sciences computer software package (SPSS) version 21.0. The findings indicated that Repayment period, Premium and Interest rate had a significant effect on profits at 5% level of significance.

Muiruri (2014) sought to investigate the role of microfinance institutions on growth of micro and small enterprise (MSE) in Thika Municipality, Kenya. A cross-sectional survey was carried that analyzed both secondary and primary data. Through random sampling technique, 285 MSEs and sixteen MFIs were selected. Data collection was done using questionnaires and interview schedules to the different respondents. Questionnaires were used to collection quantitative data on MSEs Owners and MFI managers. This data then was analyzed using the statistical packages for social sciences software (SPSS windows version 13.0). The findings were presented using both tabular and graphical presentation. The findings on the statistics in the study demonstrate that MFIs offer services to customers who are majorly (MSEs) and had contributed growth which has been rapid over the years. Finally the businesses that received MFI services reported growth in sale, revenue and number of employees employed.

Bichanga and Njage (2014) attempted to investigate the effects of MFIs on poverty reduction. The study focused on Poverty Reduction and Pamoja Women Development Programme (PAWDEP) located in Kiambu District as a case study. The study used descriptive survey design. The target population was 9 staff/administrators and 46 clients or recipients of PAWDEP. The study employed stratified sampling technique

to select staff of the selected MFIs and clients. Both qualitative and quantitative data analysis methods were used. The study revealed that PAWDEP as a microfinance institution has been providing microfinance services to different groups of women - productive or active poor and that the institution uses various strategies to deliver its services such as granting small loans to women to help them start businesses, grow their businesses and educate their children.

Korea et al., (2015) studied the effect of microfinance services on the performance of small and medium enterprises in Kenya. The study used explanatory research design and a population of relatively 429 SMEs registered by the Kiambu Municipal council. A sample of 270 enterprises was used utilizing multiple regression analysis to draw inferences on the study. Data was analyzed using statistical package for social sciences SPSS. The study found that access to saving schemes, managerial training and loans grace period to be statistically significant in determining the performance of SMEs. The study concluded that increasing provision levels of microfinance will bring about increased performance of micro enterprise.

2.5 Summary of the Literature Review

Microfinance a key development strategy for promoting poverty reduction, increasing financial performance of firms and empowerment of people economically. This is because of its potential to effectively address poverty by granting financial services to households who are not served by the formal banking sector. MFIs provide loans for businesses and mobilize rural savings and using simple and straight forward procedures that originate from local cultures and are easily understood by the population. These funds are used to finance the informal sector Small and Medium Enterprises (SMEs) in developing countries and it is known that these SMEs are more

likely to fail. Some Microfinance Institutions(MFIs) provide social intermediation services such as the formation of groups, development of self-confidence and the training of members in that group on financial literacy and management (Bichanga & Njage, 2014).

Financial sustainability theory links the ability of a business withstand all challenges to the economic performance of that organization, to the health of employees and to the stock of natural resources in the long term. Microfinance loans offer funds to start or maintain companies so that they can withstand encounters in the business world (Dunphy, 2003). Muiruri (2014) demonstrated that microfinance establishments offer services to customers who are majorly SMEs and has contributed to growth which has been rapid over the years. He added that businesses that received microfinance services reported growth in sale, revenue and number of employees employed. Adama and Agbim (2015) found that micro-credit has significant effect on self-employment, education, training and skills acquisition, and economic empowerment.

The increased involvement of entrepreneurs especially youth and women in the major markets in Nairobi Kenya in the activities of microfinance banks, NGOs, associations, cooperatives, rotating savings groups, self-help groups and savings mobilization groups suggest that further investigations on the relationship between microfinance loans and financial performance should be conducted to validate the more generalised results.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter outlines and discusses the research methodology adopted in investigating the effects of micro-finance on the financial performance of SMEs in Nairobi County. Among the relevant issues include research design, the study population, data collection techniques, data analysis methods, data validity & reliability, analytical model, and test of significance.

3.2 Research Design

Kothari (2004) defines research design as the outline showing how the study objectives are achieved, and problems under investigation are solved. The study used semi-structured questionnaire through a survey to collect data. According to Mugenda and Mugenda (1999) a survey is an effort to gather data from targeted population to determine the present status of the target population concerning the study topic. Saunders and Thornhill (2007) support questionnaires by stating that they are helpful in determining the relationships between various variables. Questions through the survey were most appropriate for this research as it enabled the collection of data from SMEs in Nairobi County and in determining the relationship between microfinance loans on the financial performance. There are various researchers who have successfully used survey for example Kamau (2008) employed this strategy to study SMEs operating in Nairobi. Inziani (2006) also employed this method to research on SMEs operating in Dandora slums in Nairobi County. The wide applicability of this method made it appropriate for this study.

3.3 Population

Saunders, Lewis and Thorn (2003) define a population as a group of people, objects, persons or items from that samples are extracted for analysis and from which the researcher wishes to make the inference. The population for this study was the SMEs operating in Nairobi County. The target population was grouped based on 17 constituencies in Nairobi County: Westlands, Dagoretti North, Dagoretti South, Langata, Kibra, Roysambu, Kasarani, Ruaraka, Embakasi South, Embakasi North, Embakasi Central, Embakasi East, Embakasi West, Makadara, Kamukunji, Starehe and Mathare.

According to Public Procurement Oversight Authority financial year (2014), there were an estimated 5,596 SMEs operating in Nairobi County of which 526 SMEs belonged to persons with disabilities, 939 SMEs belonged to women, 18 were general SMEs while the largest chunk of 4538 SMEs belonged to the youths, as shown by Table 3.1 below;

Table 3.1: Target population

Type of SME	Series	Number
Person with Disabilities	426 - 526	101
General SME	527 - 544	18
Women	545 - 1483	939
Youth	1484 - 6021	4538
TOTAL		5596

Source: Public Procurement Oversight Authority

3.4 Sample

According to Devote (2008) a sample is a set of data obtained from the statistical population using specified data collection techniques. A stratified random sampling technique will be used in this study. The study used a Krejcie and Morgan (1970) table to draw the sample shown in Appendix III. According to the table the sample population should be 357. A stratified random sampling technique was used in this study. Random sampling employed to pick SMEs for the sample. According to Mugenda and Mugenda (2003) random sampling ensures that the sample is evenly distributed and thus reducing biases in the target population a true representation of the target population. The sample distribution is as shown by Table 3.2.

Table 3.2: Target population

Type of SME	Target	Sample	Percentage
Person with Disabilities	101	6	2
General SME	18	1	1
Women	939	60	17
Youth	4538	290	80
Total	5596	357	100

Source: Public Procurement Oversight Authority

3.5 Data Collection

Data collection is the method through which desired information from the specific population is gathered and presented in a conventional way in a way that it is relevant to answering the research questions (Mugenda and Mugenda, 2003). This study used a questionnaire in data collection. A copy of which is attached as appendix II. The

questionnaire was divided into three sections, Background Study, Accessibility of Credit and Financial Performance. The study further grouped the SMEs based on the type of business (Wholesalers, Retailers, Restaurants, Cosmetics, and Service Delivery), Period of Operation, and methods through which the SME was financed. The grouping is essential in finer analysis of each business set up and operations. Secondary data will also be collected from the sampled SMEs for finer analysis of financial performances over the period.

3.5.1 Data Validity and Reliability

According to Paton (2000) validity is quality attributed to proposition or measures of the degree to which they conform to establish knowledge or truth. An attitude scale is considered valid, for example, to the degree to which its results conform to other measures of possession of the attitude. Validity therefore refers to the extent to which an instrument can measure what it ought to measure. It therefore refers to the extent to which an instrument asks the right questions in terms of accuracy. Mugenda and Mugenda (2009) define validity as the accuracy and meaningfulness of inferences which are based on research results.

The content validity of the instrument was determined in two ways. First, content validity of the instrument was determined through piloting, where the responses of the subjects will be checked against the research objectives. For a research instrument to be considered valid, the content selected and included in the questionnaire must be relevant to the variable being investigated. The researcher performed a pilot test with a randomly selected sample of five SMEs. The instruments were modified as per results of the pilot test.

Reliability of an instrument is the measure of the degree to which a research instrument yields consistent results or data after repeated trials. In order to test the reliability of the instrument to be used in the study a pilot study was carried out and a reliability coefficient computed. This established the extent to which the questionnaire elicits the same responses every time it is administered. A correlation coefficient of 0.5 was considered reliable for the study (Mugenda & Mugenda, 2009).

3.6 Data Analysis

Data analysis is the process through which data is evaluated using analytical and logical reasoning to determine every variable in the study (Web Finance, 2014). The analysis entails gathering of data from different sources, their review and analysis to form a deduction. This study used linear regression analysis model and so this study will use the analytical software in data analysis. Among the software that was used was Statistical Package for the Social Science version 21.0 (SPSS) and advanced excel for analysis. The linear regression model was applicable since it allowed simultaneous investigation of the correlations among different variables.

3.6.1 Analytical Model

The regression model that was used in this study comprised three independent variables and one dependent variable as shown below:

It was as follows:

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \epsilon$$

Where:

Y= Financial performance was determined by the overall growth of the business in terms of sales and branch networks and respondents' opinion on how well you think MFIs contribute to the success of your business. Section C.

X_1 = Microfinance loans was measured by the how much (Amount) the SME is financed. See Questionnaire .Section B. Number 11

X_2 = Age of the SME, which was measured by the years since establishment. See Questionnaire Section B. Number 13

X_3 = Credit accessibility. This was determined by the source from which the business is funded. See Questionnaire Section B. Number 14

α = Regression constant

ε = Error term normally distributed about the mean of zero.

$\beta_1\beta_3..B_n$ were the coefficients of the variation to determine the volatility of each variable to financial performance the in regression model.

3.6.2 Test of Significance

Robinson (2002) defines research validity as the extent to which the research outcomes from data analysis is a true representation of the study population and subject to scrutiny. He also defines reliability as the accuracy of the instruments used in the study (Mugenda and Mugenda, 2003). The research was reliable since the data sources are regarded credible, reliable and consistent because the selected SMEs have had operated for at least five years consecutively. The study tested the statistical significance level at 95% confidential level. The significance level helped in determining whether the chosen data is a true representation of the entire study population. The researcher used ANOVA to examine the significance of the differences among more than two samples at the same time.

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND INTERPRETATION

4.1 Introduction

This chapter presents analysis and findings of the study as set out in the research methodology. The results are presented on the effect of micro finance loans on the financial performance of small medium enterprises in Nairobi County. The data was gathered exclusively from questionnaire as the research instrument. The questionnaire was designed in line with the objectives of the study. To enhance quality of data obtained, Likert type questions were included whereby respondents indicated the extent to which the variables were practiced in a five point Likerts scale.

The study targeted to sample 357respondents in collecting data. From the study, 240 sampled respondents filled in and returned the questionnaire contributing to 67.2%. 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	240	67.2
Not responded	117	32.8
Total	357	100

Source: Research findings

4.2 Data Presentation

4.2.1 Data Validity

The researcher issued five supply chain managers in the organizations were targeted so as to conduct a pilot study. Piloting of the research instrument was necessary for various reasons: It helped to clarify the wording and grammar of the instrument so as to avoid misinterpretations; to avoid research bias; detect ambiguous questions; and to pick out in advance any problems in the methods of research. This helped to make the data used in this analysis valid.

4.2.2 Data Reliability

To test the reliability of the Likert scale used in this study, reliability analysis was done using Cronbach's Alpha as the measure. Reliability co-efficient of $\alpha \geq 0.7$ was considered adequate. In this case, a reliability co-efficient of 0.822 was registered indicating a high level of internal consistency for the Likert scale used.

Table 4.2: Cronbach's Alpha

Reliability Statistics	
Cronbach's Alpha	Cronbach's Alpha Based on Standardized Items
0.822	0.880

Source: Research findings

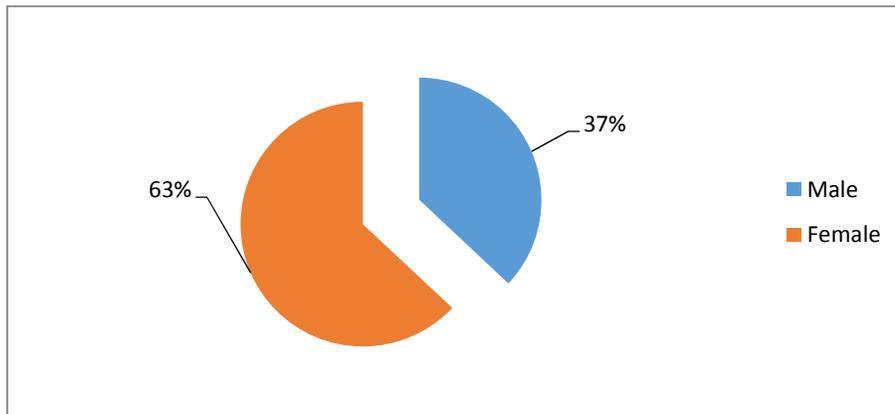
4.3 General Demographics

The study sought to ascertain the background information of the respondents involved in the study. The background information points at the respondents' suitability in answering the questions.

4.3.1. Gender of the respondents

The respondents were requested to indicate their gender. The findings were as shown in the figure below.

Figure 4.1: Gender of the respondents



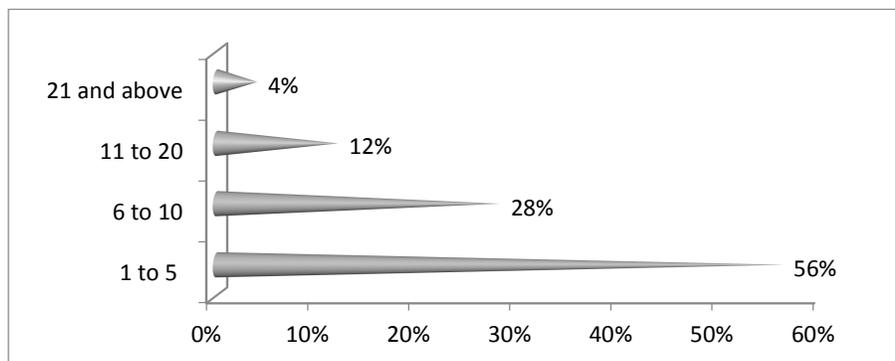
Source: Research findings

From the findings above 63% of the respondents were female while 37% were males. This depicts that majority of the respondents were females.

4.3.2 Number of employees in the organization

The respondents were requested to indicate the number of employees in their organization. The findings were as shown in the figure below.

Figure 4.2 Number of employees in the organization



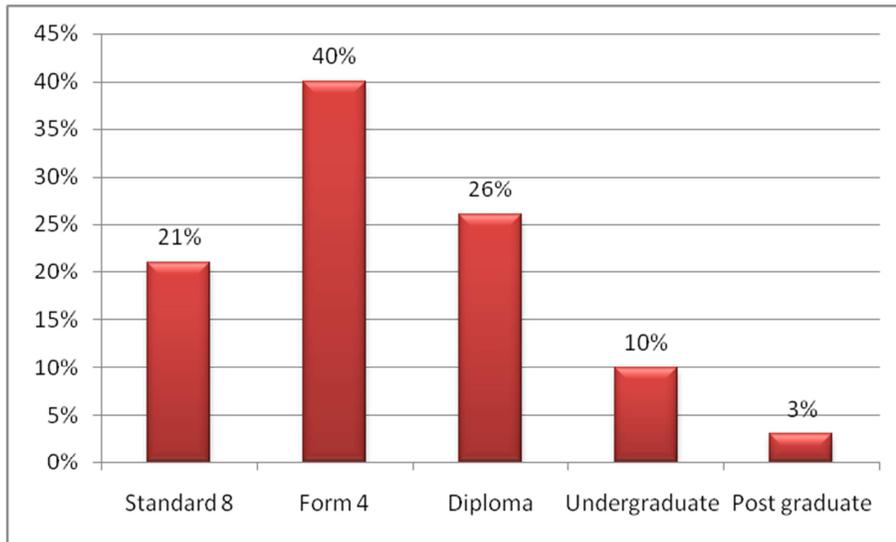
Source: Research findings

From the findings above 56% of the respondents indicate that their organizations had more than 1-5 employees, 28% indicated 6-10 and, 12% indicated 11-20 and 4% of the respondents indicated 21 and above employees. This depicts that majority of the SE' in Nairobi County had 1-5 employees.

4.3.3 Level of Education

The respondents were requested to indicate their level of education. The findings were as shown in the figure 4.3 below.

Figure 4.3: Level of Education



Source: Research findings

The findings revealed that majority of the respondents (40%) were form four holders, 26% were diploma holders, 21% were form four holders, 10% were undergraduate holders while 3% were post graduate holders. This infers that majority of the respondents in the small medium enterprises in Nairobi County were form four holders

4.3.4 Training

The respondents were requested to indicate the extent to which they have received training from MFIs or any other training institution. The responses were placed on a five Likert scale ranging from 1 (less satisfactory) to 5 (most satisfactory). The findings were as shown in table 4.3 below.

Table 4.3: Training

Skills	mean	standard deviation
Basic business skills	3.3124	0.2346
Capital Investment Decision	2.8791	0.6324
Business risk management	2.9713	0.2891
Training contributed to business financial performance	3.0127	0.7963

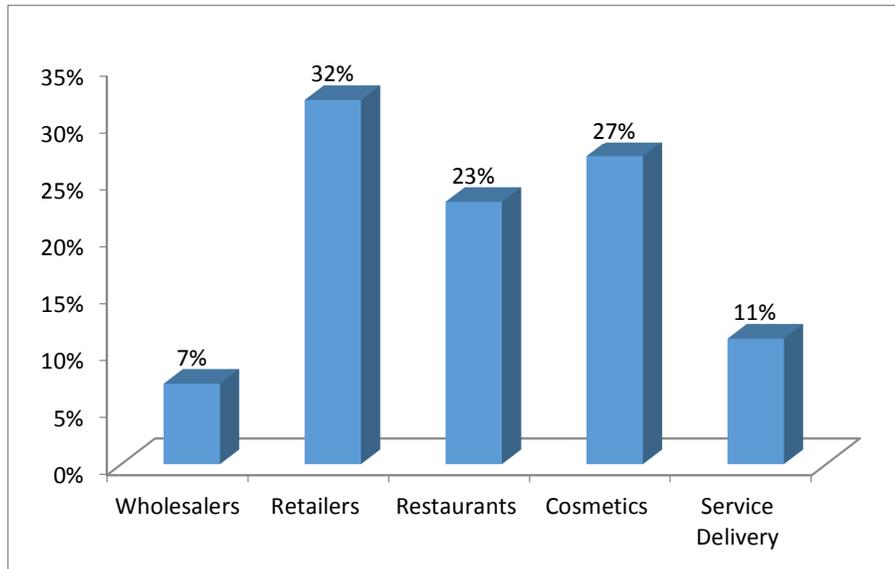
Source: Research findings

From the findings above the respondents indicated that they were satisfactory on basic business skills (mean=3.3124), and training contributed to business financial performance (mean=3.0127). In addition, respondents indicated that they were not satisfied with training offered by MFIs on business risk management (mean=2.9713) and capital Investment Decision (mean=22.8791). This infers that respondents were satisfied with training offered by MFIs on basic business skills and they indicated that training contributed to business financial performance

4.3.5 Type of business

The respondents were requested to indicate the type of business their SME engage in. The findings were as shown in the figure 4.4 below.

Figure 4.4: Type of business



Source: Research findings

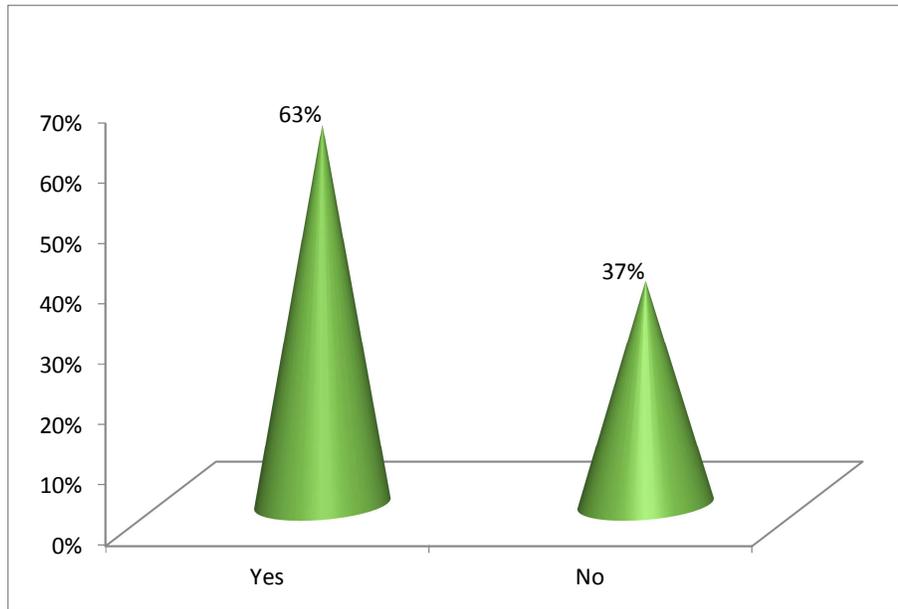
From the findings above most of the respondents (32%) indicated that the type of business their SME engage in was retailers, 27% indicated cosmetics, 23% indicated restaurants, and 11% indicated service delivery, while 7% indicated wholesalers. This implies that the type of business which most of the SME in Nairobi County engage in is retailers.

4.4 Accessibility of Credit

4.4.1 Usage of microfinance loans

The respondents were required to indicate whether they used microfinance loans. The results are presented in figure 4.5.

Figure 4.5: Usage of microfinance loans



Source: Research findings

Majority (63%) of the respondents indicated that they used microfinance loans while only 37% of the respondents indicated otherwise. This implies that majority of the SME in Nairobi County used microfinance loans

4.4.2 Challenges of accessing microfinance loans

The respondents who indicated that they never used microfinance loans were further asked to indicate the reasons that inhibit their enterprise from accessing microfinance loans. The responses were placed on the five Likert scale where 1= No extent, 2=Small extent, 3= Moderate extent, 4= Great extent and 5= Very great extent. The results are presented in table 4.4 below.

Table 4.4: Challenges of accessing microfinance loans

	mean	Standard deviation
High Interest rates	4.3612	0.6234
Bureaucracy	3.7421	0.2346
Turnaround time	3.6124	0.2632
Securities and Collateral	3.4213	0.8946
Repayment period	3.9142	0.9764
Application fees	3.3613	0.2346

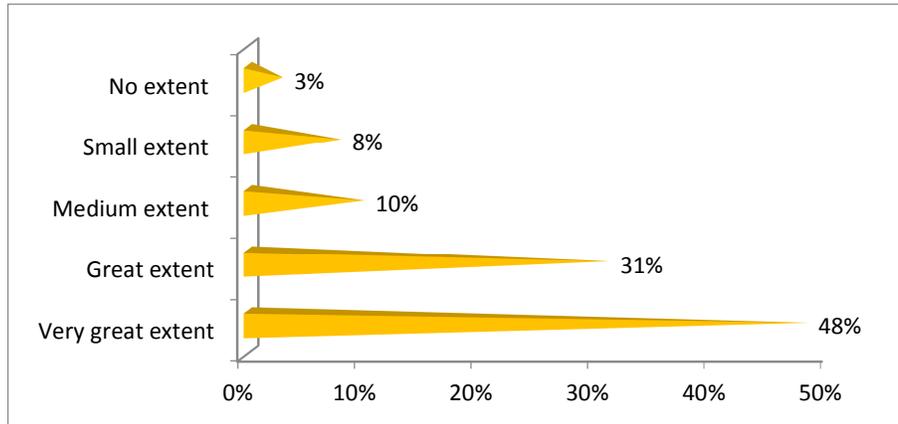
Source: Research findings

From the findings, respondents to a very great extent indicated that; high interest rates (mean=4.3612), and repayment period (mean=3.9142) inhibit their enterprise from accessing microfinance loans. In addition, to a great extent respondents stated that; bureaucracy (mean=3.7421), turnaround time (mean=3.6124), securities and collateral (mean=3.4213, and application fees (mean=3.3613) inhibit their enterprise from accessing microfinance loans. This reveals that high interest rates and repayment period inhibit some of the SME's in Nairobi County from accessing microfinance loans to a very great extent.

4.4.3 Microfinance loan and financial performance

The study sought to determine the extent to which microfinance loan influence financial performance in SME's in Nairobi County. The findings were as shown in the figure 4.6 below.

Figure 4.6: Microfinance loan and financial performance



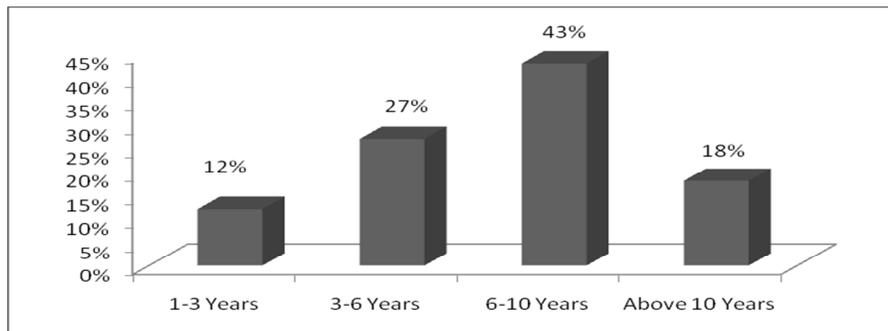
Source: Research findings

The study established that most of the respondents (48%) indicated that microfinance loan influence financial performance to a very great extent, 31% indicated to a great extent, 10% indicated medium extent, and 8% indicated small extent, while only 3% indicated no extent. This portrays that microfinance loan influence financial performance in SME's in Nairobi County to a very great extent.

4.4.4 SME duration of operation

The study required the respondents to indicate how long their SME has been operating.

Figure 4.7: SME duration of operation



Source: Research findings

The study established that most of the respondents (43%) indicated that their SME has been operating for 6-10 years, 27% indicated 3-6 years, and 18% indicated above 10 years, while only 12% indicated 1-3 years. This portrays that most of the SME's in Nairobi County has been operating for 6-10 years.

4.4.5 Satisfaction with the MFIs

The respondents were requested to indicate the extent to which they have received training from MFIs or any other training institution. The responses were placed on the five Likert scale where 1= Not Favorable, 2= Moderately favorable, 3= Favorable 4= Very favorable and 5= Most favorable. The results are presented in table 4.5 below

Table 4.5: Satisfaction with the MFIs

Statement	Mean	Standard deviation
Timeline in processing the loan	3.2146	0.6431
Interest rates	2.4612	0.3461
Grace period	2.8713	0.2364
Repayment period	3.6178	0.7986
Loan size	1.9630	0.6984
Grant of amount applied for	2.7463	0.3246
SMEs fail to expand due to limited financial resources	3.0123	0.3263
MFIs contribute to the increase of entrepreneurs who start new venture	4.1236	0.2364
SMEs increase their productivity through getting funds from MFIs that leads to enterprises growth	4.0123	0.7964

Source: Research findings

The study established that respondents were most favorable satisfied that: MFIs contribute to the increase of entrepreneurs who start new venture (mean=4.1236), and SMEs increase their productivity through getting funds from MFIs that leads to

enterprises growth (mean=4.0123). In addition, respondents were favorable satisfied with repayment period (mean=3.6178), timeline in processing the loan (mean=3.2146), and SMES fail to expand due to limited financial resources (mean=3.0123). On the other hand, respondents were moderately favorable satisfied with Grace period (mean=2.8713), Grant of amount applied for (mean=2.7463), Interest rates (mean=2.4612), and Loan size (mean=1.963). This shows that MFIs contribute to the increase of entrepreneurs who start new venture, and SMEs increase their productivity through getting funds from MFIs that leads to enterprises growth.

4.4.6 MFIs contribution to SMEs success

The study sought to determine the extent to which MFIs contribute to the success of SME's. The respondents were asked to indicate the extent to which they agreed with statements in relation to this. The responses were placed on the five Likert scale where 1= strongly disagree, 2= disagree, 3= neither, 4= agree and 5 is strongly agree. The results are as presented in Table 4.6 below.

Table 4.6: MFIs contribution to SMEs success

	mean	standard deviation
The minimum savings allowed by the MFIs affect the financial performance of the business	3.7142	0.6321
The interest rate on savings offered by the MFIs affects the financial performance of the business	4.2314	0.2413
The various types of saving accounts offered by the MFIs affect the financial performance of the business	3.3241	0.8471
Savings through mobile banking allowed by the MFIs affect the financial performance of the business	3.7641	0.6321
Micro savings service offered by the MFIs is important in the financial performance of the business	4.3714	0.4213

Source: Research findings

From the findings, respondents strongly agreed that; Micro savings service offered by the MFIs is important in the financial performance of the business (mean=4.3714), and that the interest rate on savings offered by the MFIs affects the financial performance of the business (mean=4.2314). In addition, respondents agreed that savings through mobile banking allowed by the MFIs affect the financial performance of the business (mean=3.7641), the minimum savings allowed by the MFIs affect the financial performance of the business (mean=3.7142), and that the various types of saving accounts offered by the MFIs affect the financial performance of the business (mean=3.3241). Micro savings service offered by the MFIs is important in the financial performance of the business, and that the interest rate on savings offered by the MFIs affects the financial performance of the business.

4.5 Financial Performance

4.5.1 Assessment of the overall growth

The study sought to determine the extent to which the respondents assessed the overall growth of their business. The responses were placed on the five Likert scale where 1: Very low Scale: 2: Low Scale: 3: Moderate Scale: 4: High Scale: 5: Very High. The results are as presented in Table 4.7 below.

Table 4.7: Assessment of the overall growth

Status	mean	standard deviation
Financial performance	4.2314	0.3462
Growth in sales	4.0123	0.3124
Branches	3.6142	0.1623

Source: Research findings

From the findings, respondents rated Financial performance (mean=4.2314), and Growth in sales (mean=4.0123) to be Very High. Further respondents rated Branches (mean=3.6142) to be High.

4.6 Inferential Statistics

The study further applied general Linear Model to determine the predictive power of the effect of micro finance loans on the financial performance of small medium enterprises in Nairobi County. This included regression analysis, the Model, Analysis of Variance and coefficient of determination.

4.6.1 Regression Analysis

In addition, the researcher conducted a multiple regression analysis so as to test relationship among variables (independent) on the effect of micro finance loans on the financial performance of small medium enterprises. The researcher applied the statistical package for social sciences (SPSS V 21.0) to code, enter and compute the measurements of the multiple regressions for the study.

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 (financial performance) that is explained by all the three independent variables (microfinance loans, age of the SME, credit accessibility).

4.6.2 Model Summary

Table 4.8: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.843	0.7106	0.692	0.116

Source: Research findings

The three independent variables that were studied, explain only 71.06% on the influence of micro finance loans on the financial performance of small medium enterprises represented by the R^2 . This therefore means that other factors not studied in this research contribute 28.94% of the micro finance loans on the financial performance of small medium enterprises. Therefore, further research should be conducted to investigate the other factors (28.94%) that affect financial performance of small medium enterprises.

4.6.3 ANOVA Results

Table 4.9: ANOVA of the Regression

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	2.534	4	1.267	9.025	.001 ^a
	Residual	9.307	235	2.327		
	Total	11.841	239			

Source: Research findings

The significance value is 0.001, which is less than 0.05, thus the model is statistically significant in predicting how (microfinance loans, age of the SME, credit accessibility) affect financial performance of the SME. The F critical at 5% level of significance was 2.25. Since F calculated is greater than the F critical (value = 9.025), this shows that the overall model was significant.

4.6.4 Coefficient of Correlation

Table 4.10: Coefficient of Correlation

Model	Unstandardized		Standardized	T	Sig.
	Coefficients		Coefficients		
	B	Std. Error	Beta		
1 (Constant)	1.103	0.2235		5.132	0.000
Microfinance loans	0.852	0.1032	0.1032	6.569	.001
Age of the SME	0.643	0.3425	0.1425	4.117	.004
Credit accessibility	0.473	0.1243	0.1234	4.018	.001

Source: Research findings

Multiple regression analysis was conducted as to determine the relationship between the financial performance of the SME and the three variables. As per the SPSS generated table below, regression equation

$(Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \epsilon)$ becomes:

$(Y = 1.103 + 0.852 X_1 + 0.643 X_2 + 0.473 X_3 + \epsilon)$

Where;

Y= Financial performance

X₁= Microfinance loans

X₂= Age of the SME,

X₃= Credit accessibility.

According to the regression equation established, taking all factors into account (Microfinance loans, age of the SME, and credit accessibility) constant at zero, financial performance of the SME will be 1.103. The data findings analyzed also shows that taking all other independent variables at zero, a unit increase in Microfinance loans will lead to a 0.852 increase in financial performance of the SME; a unit increase in age of the SME will lead to a 0.643 of the SME increase in financial performance, while a unit increase in credit accessibility will lead to a 0.473 increase in financial performance of the SME.

This infers that Microfinance loans contribute most to the financial performance followed by age of the SME. At 5% level of significance and 95% level of confidence, Microfinance loans, age of the SME, and credit accessibility were all significant in financial performance of the SME.

4.7 Interpretation of the Findings

This section attempts to provide vivid interpretation of the findings obtained relating to the objective of the study which was to investigate the effect of micro finance loans on the financial performance of small medium enterprises in Nairobi County. The regression equation above has established that taking all factors into account (Microfinance loans, age of the SME, and credit accessibility) constant at zero, financial performance of the SME will be 1.103. The data findings analyzed also

shows that taking all other independent variables at zero, a unit increase in Microfinance loans will lead to a 0.852 increase in financial performance of the SME; a unit increase in age of the SME will lead to a 0.643 of the SME increase in financial performance, while a unit increase in credit accessibility will lead to a 0.473 increase in financial performance of the SME.

This infers that Microfinance loans contribute most to the financial performance followed by age of the SME. At 5% level of significance and 95% level of confidence, Microfinance loans, age of the SME, and credit accessibility were all significant in financial performance of the SME. Similarly the findings on the statistics in the study by Muiruri (2014), demonstrate that MFIs offer services to customers who are of the low income earning level and the disadvantaged, majorly women, persons with disabilities and youths to start up or expand SMEs and this has contributed to economic growth which has been rapid over the years.

Asemelash (2002) confirmed a positive impact of microfinance on beneficiaries as compared to non-beneficiaries. He showed that microfinance has impacted positively income, asset building, and access to schools and medical facilities. However credit alone can't automatically lead to increased financial performance. Madole (2013) established that, age or experience of the SMEs owners, and, credit accessibility influence the access of credit and that once accessed, there is need for training on best investment decisions or maintenance of increased profits. The study concluded most of the small businesses depend on loan for business capital growth which plays a very crucial role to promote small business financial health.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter presents the summary of the data findings on the effect of micro finance loans on the financial performance of small medium enterprises in Nairobi County, the conclusions and recommendations are drawn there to. The chapter is therefore structured into summary of findings, conclusions, recommendations, limitations and area for further research.

5.2 Summary

The objective of the study was to investigate the effect of micro finance loans on the financial performance of small medium enterprises in Nairobi County. 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 regression analysis. From the study, it has been found that majority of respondents were satisfied with training offered by MFIs on basic business skills and they indicated that training contributed to business financial performance.

The study established that the type of business which most of the SME in Nairobi County engage in is retailers. The study also found out that the majority of the SME in Nairobi County used microfinance loans. The study also found that high interest rates and repayment period inhibit some of the SME's in Nairobi County from accessing microfinance loans to a very great extent.

The study also found that microfinance loan influence financial performance in SME's in Nairobi County to a very great extent. In addition, the study revealed that MFIs contribute to the increase of entrepreneurs who start new venture, and SMEs increase their productivity through getting funds from MFIs that leads to enterprises growth. The study revealed that Micro savings service offered by the MFIs is important in the financial performance of the business, and that the interest rate on savings offered by the MFIs affects the financial performance of the business.

The study found out that taking all factors into account (Microfinance loans, age of the SME, and credit accessibility) constant at zero, financial performance of the SME will be 1.103. The data findings analyzed also shows that taking all other independent variables at zero, a unit increase in Microfinance loans will lead to a 0.852 increase in financial performance of the SME; a unit increase in age of the SME will lead to a 0.643 of the SME increase in financial performance, while a unit increase in credit accessibility will lead to a 0.473 increase in financial performance of the SME. At 5% level of significance and 95% level of confidence, the study found out that Microfinance loans, age of the SME, and credit accessibility were all significant in financial performance of the SME.

5.3 Conclusion

The study concludes that the type of business which most of the SME in Nairobi County engage in is retailers. The study also concludes that the majority of the SME in Nairobi County used microfinance loans. The study concludes that high interest rates and repayment period inhibit some of the SME's in Nairobi County from accessing microfinance loans to a very great extent.

The study also concludes that microfinance loan influence financial performance in SME's in Nairobi County to a very great extent. In addition, the study concludes that MFIs contribute to the increase of entrepreneurs who start new venture, and SMEs increase their productivity through getting funds from MFIs that leads to enterprises growth. The study concludes that Micro savings service offered by the MFIs is important in the financial performance of the business, and that the interest rate on savings offered by the MFIs affects the financial performance of the business.

The study concludes that taking all factors into account (Microfinance loans, age of the SME, and credit accessibility) constant at zero, financial performance of the SME will be 1.103. The study also concludes that at 5% level of significance and 95% level of confidence, the study found out that Microfinance loans, age of the SME, and credit accessibility were all significant in financial performance of the SME.

5.4 Recommendations for Policy and Practice

Based on the key findings, the study made the following recommendations. Microfinance Institutions should enhance training of their clients on the entrepreneurial skills so as to enhance their skills as a large proportion of the respondents were found to be certificate holders of high school graduates hence they lacked the necessary business management skills. The government should invest heavily in youths' education and if possible offer free or subsidized entrepreneurial training especially for the secondary school graduates who are unable to proceed to university or any other tertiary education.

The study established that high interest rates and repayment period inhibit some of the SME's in Nairobi County from accessing microfinance loans to a very great extent. It is in this line of thought that the study recommends that Microfinance Institutions

should lower interest rates and as well increase repayment period. The management of MFIs should revise their lending policies and requirements so as to ensure that most of the traders can be able to access credit more easily. This would be effective in attracting more customers to the MFIs as well as enabling the traders to sustain their businesses.

The study also recommends the MFIs carry out sensitization campaigns on the need to save among the traders. This would be important in ensuring that the customers share of savings is higher thus making it easier to access loans. The study also recommends that the MFIs use that traders savings as part of collateral since most may not have large tracts of land or the physical collateral needed.

5.5 Limitations of the study

Most SME's may not be willing to provide data related to their financial performance and inner details of the banks. Some respondents also gave false information responses to the questions asked. It was very hard to convince them of the intention of my research in a bid to collect information from them based on the sensitivity of the sector. However, with the assistance of friends working in the sector and with the introduction letter from the university the researcher was given the opportunity to undertake the research. Because most of the SME operators have low education levels, the researcher faced a challenge of explaining technical terms to the respondents. However, to overcome this challenge, the researcher explained most of the terms in Kiswahili which most of the entrepreneurs could easily relate with.

Some of the respondents did not co-operate to the response and attempted to ignore the questionnaires. The researcher however, minimized non response cases by taking and collecting summary questionnaires by hand from each respondent. Also, by

having trustworthy people to distribute and collect the questionnaires and knowing how best to deal with those reluctant to questions.

Most of the respondents were busy throughout and had to continuously be reminded and even persuaded to provide the required information. Time was also a limiting factor considering that the research was an employee in different sector. MFIs also felt that by introducing the researcher to its clients was in violation of confidentiality clause hence the researcher had to visit the institution very early in the morning and persuade them to allow him accompany the credit officer to the field.

5.6 Suggestions for Further Research

This study used semi-structured questionnaire through a survey to collect data thus may limit generalization in analytical terms. This study thus therefore recommends a similar study but employing longitudinal survey and on a large sample obtained through stratified sampling to cater for SMEs under different finance programs. Furthermore, future studies could compare the SMEs utilizing MFIs services and those not using such services but whose owners are subjected to the same economic conditions or rather in the same economic class. This will cement the generalization that MFIs' services have positive effects on the financial performance of SMEs as opposed to those that don't utilize MFIs services

The study also recommends that a similar study should be conducted in some of remote rural areas in the country where there are challenges such as poor transport infrastructure and even with cultures that do not value education. With such research, it can be evaluated to whether the MFIs can still have an effect on the financial performance of SMEs.

The study also recommend a similar study to be conducted on people living with disabilities (PWD).This is also another category that have been overlooked by the formal banking sector and since microfinance strive to narrow such gaps, this study will also prove whether MFIs services are able to spur the financial performance of its clients.

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APPENDICES

Appendix I: Letter to Respondents

Dear respondents,

The purpose of this letter is to request you to kindly assist me to carry out a research on; **THE EFFECT OF MICRO FINANCE LOANS ON THE FINANCIAL PERFORMANCE OF SMALL MEDIUM ENTERPRISES IN NAIROBI COUNTY.**

Your responses will be kept confidential and will not be used for any other purpose. Please be honest while giving your responses. Attached to this letter find a copy of the questionnaire. Your cooperation will be highly appreciated.

Thanks in advance.

Yours faithfully,

DANIEL MUSIMO MOROBE

Appendix II: Questionnaire

This questionnaire will be used collect data on the effects of Microfinance loans on the financial performance of small, medium enterprises in Nairobi County. Any information given by the respondents during this exercise will be treated with strict confidentiality. Kindly answer the following questions by writing a brief answer statement or ticking in the spaces provided as will be applicable.

Section A: Background Information

1. Name of the business_____

2. When was your business established_____

3. Constituency in which your SME operates_____

4. Gender of entrepreneur

i. Male

ii. Female

5. How many employees does the business have

i. 1 - 5

ii. 6 - 10

iii. 11 - 20

iv. 21 and above

6. What is the education level of the Manager?

- i. Std 8
- ii. Form 4
- iii. Diploma
- iv. Undergraduate
- v. Postgraduate

7. In the scale of 1-5, rate below in respect to training you have received from MFIs or any other training institution. Note 1=less satisfactory; 2=moderate satisfactory; 3=satisfactory; 4=very satisfactory and 5=most satisfactory.

Skills	Most satisfactory	Very satisfactory	Satisfactory	Moderate satisfactory	Less satisfactory	Note received
Basic business skills						
Capital Investment Decision						
Business risk management						
How satisfied has your training contributed to your business financial performance?						

8. What is the main business activity?

9. Kindly tick [] one of the options provided showing the type of business the SME engage in,

- i. Wholesalers []
- ii. Retailers []
- iii. Restaurants []
- iv. Cosmetics []
- v. Service Delivery []

Section B: Accessibility of Credit

10. How much is the worth of your business? _____

11. Do you use microfinance loans to finance your business

- i. Yes []
- ii. No []

a. **IF YES.** How much does your enterprise spend per annum on loans

_____Kshs.

b. IF NO. What inhibits your enterprise from accessing microfinance loans?

	Very great extent	Great extent	Medium extent	Small extent	No Extent
High Interest rates					
Bureaucracy					
Turnaround time					
Securities and Collateral					
Repayment period					
Application fees					
Others					

12. Kindly tick one []. To what extent does Microfinance loan affect your financial performance

- i. Very great extent []
- ii. Great extent []
- iii. Medium extent []
- iv. Small extent []
- v. No extent []

13. How long has the SME been operating?

- i. 1-3 Years []
- ii. 3-6 Years []
- iii. 6-10 Years []
- iv. Above 10 Years []

14. This section inquires how satisfied you are with the MFIs suppose you have received funding from any.

Statement	Most favorable	Very favorable	Favorable	Moderately favorable	Not Favorable
Timeline in processing the loan					
Interest rates					
Grace period					
Repayment period					
Loan size					
Grant of amount applied for					
SMEs fail to expand due to limited financial resources					
MFIs contribute to the increase of entrepreneurs who start new venture					
SMEs increase their productivity through getting funds from MFIs that leads to enterprises growth					

15. Please give your opinion on how well you think MFIs contribute to the success of your business.

Statement	Strongly Disagree	Disagree	Neither	Agree	Strongly Agree
The minimum savings allowed by the MFIs affect the financial performance of the business					
The interest rate on savings offered by the MFIs affects the financial performance of the business					
The various types of saving accounts offered by the MFIs affect the financial performance of the business					
Savings through mobile banking allowed by the MFIs affect the financial performance of the business					
Micro savings service offered by the MFIs is important in the financial performance of the business					

Financial Performance

16. Please give your assessment of the overall growth of your business using the response scale below Scale: 1: Very low Scale: 2: Low Scale: 3: Moderate Scale: 4: High Scale: 5: Very High

%	Most Satisfactory (5)	Very Satisfactory (4)	Satisfactory (3)	Moderately Satisfactory (2)	Less Satisfactory (1)	Do not know (0)
Financial performance						
Growth in sales						
Branches						

Appendix III: Table for determining sample size from a given population

N	S	N	S	N	S	N	S
10	10	150	108	460	210	2200	327
15	14	160	113	480	214	2400	331
20	19	170	118	500	217	2600	335
25	24	180	123	550	226	2800	338
30	28	190	127	600	234	3000	341
35	32	200	132	650	242	3500	346
40	36	210	136	700	248	4000	351
45	40	220	140	750	254	4500	354
50	44	230	144	800	260	5000	357
55	48	240	148	850	265	6000	361
60	52	250	152	900	269	7000	364
65	56	260	155	950	274	8000	367
70	59	270	159	1000	278	9000	368
75	63	280	162	1100	285	10000	370
80	66	290	165	1200	291	15000	375
85	70	300	169	1300	297	20000	377
90	73	320	175	1400	302	30000	379
95	76	340	181	1500	306	40000	380
100	80	360	186	1600	310	50000	381
120	86	380	191	1700	313	75000	382
120	92	400	196	1800	317	100000	384
130	97	420	201	1900	320		
140	103	440	205	2000	322		

Source: Krejcie and Morgan (1970, p.608)

Notes: N = Population size; S = Sample size

Appendix VI: Work Plan

ACTIVITY	DURATION IN MONTHS									
	2015									
	Jun	Jul	Aug	Sep	Oct					
Proposal development	■	■								
Presentation of proposal		■	■							
Correcting proposal			■	■						
Reconnaissance visit of study site & seeking research permit				■	■					
Pre-testing questionnaires				■	■					
Data collection					■	■				
Data analysis						■	■	■		
Presentation of preliminary results							■	■		
Project writing and draft submission							■	■		
Project presentation								■	■	
Project correction and submission								■	■	

Appendix VII: Budget

The table below provides the budget for all the expenses that the researcher will incur.

Activity	Amount in Ksh.
Transport ₁	30,000
Writing Materials ₂	10,000
Typing, Photocopying and Binding ₃	20,500
Pilot study ₄	10,000
Airtime ₅	5,000
Miscellaneous ₆	10,000
Total	85,500

Source: Researcher

Notes:

1. Travelling expenses.
2. Payment for the purchase of writing materials such as foolscaps and pens.
3. Printing and binding the 10 final copies of the research proposal report.
4. Payments of pilot study.
5. Amount set aside for any uncertainties that are unforeseen at the point of planning.