THE EFFECT OF MICROFINANCE SERVICES ON FINANCIAL PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES IN KAWANGWARE, NAIROBI COUNTY- KENYA

BY

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DECLARATION

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

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Reg. D61/67681/2011

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

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I dedicate this project to my family for their immeasurable support throughout my study.

ACKNOWLEDGEMENT

ABSTRACT

The study sought to investigate the effects of Microfinance finance services on financial performance of small and medium enterprises. The study specifically sought to find the effect of Micro-credit (loans), training, Micro-savings and Insurance services on financial performance of SMEs.

The research design used was descriptive survey study. The researcher used primary data which was obtained through self administered questionnaire with closed and prose questions. SPSS was used to perform the analysis as it aided in organizing and summarizing the data. The analyzed data was represented in tables, charts and crosstabs.

The study established that the four microfinance services; micro-credit (loans), savings, training and insurance have significant effect on the financial performance of SMEs. The study recommended that the government and the MFIs regulating bodies support MFIs to facilitate their growth and increase capacity. It is through this support that MFIs can be able to reach more SMEs.

TABLE OF CONTENT

LIST OF TABLES

LIST OF FIGURES

LIST OF ABBREVIATIONS

AMFI :   Association of Micro Finance Institutions.

CBK: Central Bank of Kenya.

CGAP: Consultative Group to Assist the Poor.

DTIs :   Deposit-taking Institutions

FSAs: Financial Services Association.

GDP: Gross Domestic Product

K-Rep :   Kenya Rural Enterprise Program

MFIs :   Micro Finance Institutions.

ROSCA: Rotating Saving and Credit Association

SMEs: Small and Medium Enterprises.

SPSS: Statistical Package for Social Sciences.

CHAPTER ONE: INTRODUCTION

1.1. Background of the study

Small and medium enterprises (SMEs) have contributed greatly in shaping the economies of both developing and developed countries. The SMEs have particularly participated in creation of wealth and employment. In South Africa SMEs provide almost 60% of employment, account for about 95% of the formal business entities and contribute about 51% to 57% of GDP (Kongolo, 2010). In Canada, the sector contributes and 43% of private sector GDP and approximately 60% of the Canada's non-public sector employment. In UK the SMEs account for 1.48 trillion sterling Pounds in terms Gross Domestic Product (GDP). The sector employs 14.23m people, out of a working population of approximately 30 million. In South America, MSEs have absorbed more than 85% of the total private sector employment and they form over 95% of the total number of business establishment (Sithore, 2009).

Definition for SMEs varies from country to country. The basis of definition is either on the number of employees or turnover or asset accumulated. SMEs in Europe are considered to have employees not more than 250 and in the United States of America not more than 500 (Natarajan & Wyrick, 2011). In Kenya, SMEs are considered to be business ventures in both formal and informal sector, having sales volume of less than four million shillings and employing not more than 100 employees (Kenya Micro and Small enterprises bill, 2006). There are over 2.4 million Kenyans employed by approximately 900,000 small and medium enterprises and contributing about 59% of the country's GDP (ILO, 2013).

The notion of Microfinance started as micro savings and credit in early 1700's. The proponent was Jonathan Swift, an Irishman who launched the Irish loan fund. This micro credit firm targeted the poor household in Ireland. This notion has spread across the globe, targeting the neediest rural and urban poor residents (Lindsay, 2010). Professor Yunus (2003), who is seen as the founder of Microfinance as a result of the success of Grameen Bank in Bangladesh clearly specifies that Microcredit cannot eradicate poverty instantly. However, microcredit can bring poverty to the end for many and minimize its cruelty for others.

According to CGAP (2012) most of the SMEs depend on micro financial services for them to survive in the market. Both borrowing and saving with MFI enables micro-entrepreneurs increase profits through servicing loans at low interest rates and having access to a variety of suitably devised loan products. Managing of working capital is also enhanced through borrowing and savings. (Ledgerwood, 2008). MFIs target prospective entrepreneurs with an objective to minimize poverty. The common conviction is that when potential entrepreneurs are well facilitated, their level of poverty diminishes because of the increase of their income. The focus of most MFIs is on operating businesses; only a little fraction of their portfolio is invested as seed capital to start-up businesses, thereby strategizing on reducing their risk horizons. Besides financial services, most entrepreneurs need skill training to enable them run their businesses successfully. (Ledgerwood, 2008).

1.1.1 Microfinance Services

Microfinance refers to the entire flexible structures and processes by which financial services are delivered to Micro enterprises as well as the poor and low income population on a sustainable basis (Ledgerwood,1999).The major microfinance services include savings, Micro-loans (lending loans), training and insurance. In east and central Africa, the microfinance sector in Kenya is more vibrant with large branch net work that gives excellent service to entrepreneurs. The demand for Microfinance institution services in Kenya is increasing at a steady rate.   Between 2006 and 2009, the demand increased from 1.7 % to 3.4% of the total population in the respective years.(FinAccess National Survey, 2009), The survey found out that out of the 17.4 million adults in Kenya, 26.4% have access to financial services through formal and semi formal (MFIs and SACCOs) institutions, 35.2% use informal services (ROSCAs, family/friends) and 32% are financially excluded (FinAccess National Survey, 2009). By December 31st 2007, AMFI had registered 34 MFI's as its members which comprise NGO's, companies, trusts, societies and commercial banks, among others Out of these, twenty one institutions had an estimated 1.1 million institutional savers and 250,000 borrowers with a loan portfolio of Kshs 4.261 billion (CBK, 2011).

According to (Microfinance Act, 2006) MFIs in Kenya are classified and registered into three different tiers: (Tier 1) deposit-taking institutions (DTIs), (Tier2) credit only non deposit taking institutions, (Tier 2) informal organizations supervised by an external agency other than the government. Other category involves such as Societies (ROSCAs), club pools and financial services associations (FSAs). MFIs are represented by an umbrella organization, Association of Microfinance Institutions (AMFI) registered in

1999 whose main role is promotion of the growth of the MFIs and supporting them to build capacity (Microfinance Act, 2006). These microfinance institutions provide financial services to the individual, SMEs as well as providing other financial support to the same category such as financial management literacy, accounting and financing skills. The famine and price increases that distressed the economy in 2010 and 2012 almost affected MFIs in Kenya. The Central Bank of Kenya (2013) and Kenyan government recognizes that access to finance is fundamental in developing contemporary economy. The MFIs sector is stronger than before because of improved policies and modern strategies of delivering financial services.

1.1.2 Financial Performance

Performance is a concept that is extensively used in various areas. According to Moullin (2003) in enterprise management an organization's performance is "how well the organization is managed" or "the value the organization delivers for customers and other stakeholders." Performance is the outcome of all of the organization's operations and strategies (Wheelen& Hunger, 2002). The two fundamental parameters of performance are effectiveness and efficiency (Neely et al., 2002). SMEs can measure their performance by determining how they are sustaining themselves and ability to create employment and wealth (Sandberg et al., 2002). Financial performance is conclusions drawn from financial analysis of a business. For purposes of making investment and financial decisions, it is critical to evaluate and interpret financial records along with appropriate information. According to Hicks and Nichans (1998), financial performance can be defined as the accomplishment of a given task that is measured using predetermined standards of accuracy, completeness, efficiency and effectiveness.

4

Financial performance measures are used to evaluate how well a business enterprise is using its resources to make profits. It is a subjective measure of how a firm can use assets from its primary mode of business and generate revenues (Schon, 2008). The central concern for most organizations is to measuring financial performance accurately for accounting purposes. The developing of strategic plans, assessing of an organization's completion of objectives and managers remuneration depend on performance measurement systems (Ittner&Larcker, 1998).

1.1.3 Microfinance Services on Financial Performance of SMEs

Due to poor security or collateral base, most SMEs are disqualified from accessing credit markets (Omiti and Kimuyu, 2000). Sources of financing small businesses include personal savings, low interest loan from relatives and informal sources. In Kenya SMEs are making contributions to the country's GDP of between 18-25%. Approximately 17% of employees working in Kenya are engaged by the sector (KREP Holdings CBS and ACEG, 2009). According to Mead (2008) SMEs face exceptional challenges in their systems of operation or management structure and financing, which affect their growth and profitability.

Insufficient training in management and practice is common to many SME owners or managers. Most of them come up with unconventional systems of managing their business that in most cases end up being disastrous. Eventually the running of the whole business is based more on instinctive than well reasoned out decisions; instead of being more concerned with long-term goals, most entrepreneurs are concerned with day –to – day operation and are more opportunistic than strategic (Hill, 1987). Because of the creativity required, this attitude may be key pillar at the setting-up level of the business.

However, intricate decisions there after require high level of exposure, knowledge and expertise. A great number of SMEs owners have inadequate education. This exposes them to a lot of disadvantages especially when business environment and technology changes (King& McGrath, 2002).

1.1.4 Small and Medium Business Enterprises

Small and medium enterprises are regarded as business ventures in both formal and informal sector, having sales volume of less than four million shillings and employing not more than fifty employees (Kenya Micro and Small enterprises bill, 2006). Information availed by National Chamber of Commerce indicate that small and Medium business enterprises within Kawangware town are diverse. They include Hardware-selling building materials, Electrical shops, Green groceries, workshops mainly owned by Jua Kali artisans; here we have carpentry workshops, metal workshops, garages among others. Another set of small business enterprises comprise wholesale and retail stores, cyber cafes, advertising agencies, professional and personal service firms, tailoring shops, hotels, restaurants, bars, boutiques, saloons, day care centers, employment and land buying agencies, transport industry among others. A tour of the town confirmed that indeed these are the major small business enterprises found in the town.

Microfinance services act as a panacea towards less empowered SMEs both economically and socially. Based on the principle that access to finance could improve the life of the poor and those with low income, Microfinance institutions have emerged to provide loans, savings, training and insurance to the poor and SMEs . A range of financial

services are needed by SMEs to enable them deal with array of consumption needs, fluctuations of income, make use of opportunities and handle emergencies.

1.2 Research problem

In most developing countries, formal financial markets serve only a small percentage of population often not more than 20% - 30%. Lack of Access to banking and other financial services like training, loans and insurance are some of the problems facing SMEs. These constraints exclude most SMEs from full participation in the financial sector (Sucre Peyes, M.A., 2009). The introduction of MFIs in most countries is a strategy to develop another alternative of financial support that will enable those with less income and their SMEs raise their income, hence contribute to the growth of the economy of the country and reduce scarcity of income (Kessy&Urio, 2006). According to Waithanji (2011) MFIs offer loans to SMEs at affordable interest rate and easy repayment installments. This is a benefit that enables entrepreneurs to run their business with minimal interruptions. He also found that SMEs borrow investment capital and they use it for the purpose in which they borrowed for, most of them consider MFIs their only source of financing their business activities. Microfinance makes a substantial input to minimizing poverty through asset buildup and constant income generation (Mosley, 1999).

The study carried about the impact of microfinance on business performance in Addis Ababa-Ethiopia (Mochona, 2006), depicted that only a few of business ladies reported growth of income from their business activities. The women were clients of Gasha Microfinance Institution.

Despite the critical role played by the SMEs in economic growth, majorities commence their operation while undercapitalized. One out four small businesses fails within the first few months of operation in Kawangware town due to inadequate finance and poor management of the business. The study recommended that there is need to enhance financial support to the SMEs to ensure sustainable growth and survival.

According to Mochana (2006), the study he carried in Addis ababa- Ethiopia indicates that there was no significant impact of microfinance services on financial performance of SMEs. This finding is not consistent with other studies and further studies should be carried to determine whether financial performance of SMEs is influenced by Microfinance services. The question therefore is: Do microfinance services have effect on financial performance of SMEs? Have critical factors been evaluated to measure the relationship between microfinance services and financial performance of SMEs?

1.3 Objective of the Study

The critical objective of this study is to establish the effect of microfinance services on financial performance of small and medium enterprises in Kawangware town, Nairobi County.

1.4 Value of the Study

First and foremost, the findings of this study will be mainly be useful to the forthcoming entrepreneurs as they will be in a superior position to understand the importance engaging in microfinance institution. The study findings will also help ineffective small business enterprises to take off and also new SMEs to succeed while existing ones to grow exponentially.

Secondly, a great number of researchers and scholars will benefit from the conclusions of this study. More skills and knowledge on the effect of microfinance services on financial performance of SMEs will be accessed by learners in the library through a documented report of this study. The study will also contribute enormously to the writings on microfinance which will be part of information useful to stakeholders in academic circles and researchers who want to further in this study.

Thirdly, government can use the study information to develop support programs and policies that support financing of small business enterprises. The findings are also critical in the development of suitable policies for supporting SMEs, empowerment of low income earners and increase of resources with a view of poverty alleviation.

Lastly, the top-level management of Financial Institutions will use the study to understand why some SMEs fail to grow their businesses while others succeed. This information will be useful in setting up lending policies in order for the microfinance to reduce risks of defaults and hence improve the financial performance of these organizations.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter mainly focuses on theories that underpin the innovation and models of microfinance services that have an effect on financial performance of SMEs.The chapter also presents literature and previous studies that have been conducted on the study topic.

2.1.1 Traditional Theory of Financial Innovation

This theory was laid down by Sundbo in 1997; he suggested two paradigms in this theory based on the fundamental prototypes, namely entrepreneur paradigm based on two different models of innovation process and Technology – economic paradigm. In the entrepreneur paradigm of innovation Sundbo (1997) portends the entrepreneurial act of the players in the market drive financial innovation. It mostly involves the development of new financial entrepreneurs and managing of the old entrepreneurships in addition to the products and process innovation. Technology – economic paradigm put emphasis on the technological development as the center of the innovation process which was pegged on the random technology progression.

MFIs have innovated services that meet the demand of SMEs. The major services most MFIs have developed include: savings, Lending loans, training and insurance. These services are sort by MSEs

2.1.2 Financial Constraints Theory

This theory dates back to 1950 when Schumpeter discovered that firms innovate to address the constraints and inconveniences caused by market imperfections, regulation, operation costs and taxes. Silber (1983) also added that financial innovation is done to lessen the

financial constraints that limit the firm's earning capacity; therefore firms innovate to optimize the returns on capital in the light of the firms' goals. Silber further suggested that firms need to continuously renew themselves to prosper in this dynamic environment.

According to Tufano (2002) financial innovation came about as a result of high interest rates, taxes and regulation. Therefore, MFIs innovated to circumvent these constraints to lessen the cost of borrowing, reduce expenses and improve investment options. Innovation also seeks to tackle the financial investment constraints through low deposits, less interest income, constrained lending, consequently less demand for deposits and the desire for efficiency, among others. SMEs become innovative in sourcing services that will enhance profit making and improve their general performance.

2.1.3 Models on Lending

According to Crabb& Keller (2006), there are three microfinance loaning models engaged globally. All microfinance institutions work towards common objective despite diverse approach. The common objective is to reduce poverty and accelerate economic growth. MFIs recognize lending methodologies as the best strategy in providing services required by SMEs. Consequently, it follows that the success of the SMEs and its sustainability are likely determined by the degree to which the group lending methodologies are employed.

2.1.3.1 Individual Lending Model

The model is used to lend loans to persons who are not necessarily in membership of any group that can be collectively responsible for servicing the loan (Ledgerwood, 2000). Each loan is distinctively custom-made to suit individuals and businesses involved. It is an approach that mostly applied to urban entrepreneurs or small farming activities in

upcountry, given that security is usually necessary. MFIs will continue to lend to borrowers depending on the relationship maintained between the two parties.

2.1.3.2 Group Lending Model

This strategy originated from Grameen Bank of Bangladesh. Groups of women in the rural and landless who wanted to engage on income-generating activities but were underfinanced were engaged first in lending of microloans. The approach framework strategy was to have groups of four to seven and each group member was to contribute savings for a period of 1 to 2 months before accessing any loan. Saving was encouraged to be a continuous practice during the period of servicing the loan. Other binding conditions to all members before loaning and after include pre-credit training, compulsory weekly meeting and timely remittance of money. All previous loans outstanding must be fully settled before a borrower receives another loan. All members of the group are subjected to the process.

2.1.3.3 The Village Banking Model

These are rural banks authorized or required to manage credit and savings associations within a given community and enhance access to financial services in the local area. They are also mandated to establish community self-help group and assist members amass savings (Ledgerwood, 2000). Most MFIs are financed by the mobilization of members' funds and by advances from microfinance institutions. Most SMEs develop their business from this kind of services.

2.2 Measures of Financial performance for SMEs

The recommended standard measures for financial performance include: liquidity, solvency, profitability, financial efficiency and repayment capacity. Liquidity measures the capacity of a business to meet financial responsibility as they fall due with minimal disruption of the normal operations of the business. The two main measures of liquidity are current ratio and working capital. Solvency measures amount of borrowed capital used by the business comparative to owner's equity capital invested in the business. Its measures provide an indication of the business's ability to pay back all creditors if all assets were sold. The extent to which a business generates profits from factors of production like land, labor, management and capital, is measured by profitability. The focus of profitability analysis is on how revenue relates or compares with and expenses and on the level of profits in comparison with the volume of investment in the business. Financial efficiency determines how efficient the business is in using factors of production. It indicates or shows how input and output interacts in an effort to add value to the final product. Repayment capacity measures the ability to repay debt from both business and non- business income.

The above measures can be determined if data can be extracted from financial records of a business entity. Some SMEs don't keep financial records that can be used to extract data for analysis and measure their financial performance. Other indicators that are equally effective and applicable in measuring financial performance include Business capital, Liquidity, asset accumulation, Savings and risk management strategy. All these indicate increase in profits, liquidity (indicated by working capital) and assets.

2.2.1 Business capital

This is money used to invest in a project or company. Access to this money gives an entrepreneur a great competitive advantage. SMEs have been able to accumulate business capital through the financial services offered by the MFIs, especially through loan products like development loans, asset loans and emergency loan. These Loans allow SMEs and people in general to become self-employed or to significantly improve their income situation. Hossain (1988) indicates that Grameen bank enabled clients to accumulate capital and this was the greatest impact the bank made in empowering the poor.

2.2.2 Savings

Saving is delayed expenditure. MFIs allow SMEs to save money in a secure and suitable form. Income fluctuation affects SMEs's performance and to mitigate this, they save when they have surplus income in order to have sufficient money to spend during seasons of deficit income. When savings accumulate to large lump sums, they can not only protect SMEs against risks but can also be used to enhance or boost investment in opportunities that presents themselves unexpectedly.

2.2.3 Liquidity

Liquidity is the ability of the business to meet financial obligations as they become due in the short term without disrupting the normal operations of the business. It indicates the extent to which current assets when liquidated will cover current obligations. A common measure of liquidity is working capital (Bruce, 1996). Working capital is current asset

minus current liabilities - (cash, receivables and inventory) minus (debt obligations due within one year). Many MFIs provide SMEs with credit serviced within one year. This credit is mainly used to manage current assets and current liability.

2.2.4 Risk management strategies

This is the recognition, estimation and risk prioritization followed by harmonized and economic use of resources to reduce, and manage the probability and impact of unforeseeable events. Low-income entrepreneurs are susceptible to risks. Insurance is one strategy SMEs use to mitigate the impact of risks. Insurance guarantees compensation for specified losses, damages, illness or death in return for payment of premium. Most poor entrepreneurs are risk- averse and insurance provides buffer against risks that most entrepreneurs are exposed to. By providing protection against possible eventualities, insurance insulates the business from liquidation of its assets in the event of a loss or misfortune. It is critical for SMEs to safeguard their cash in order to manage everyday expenditure and incidents. These are little amounts held in highly liquid form. Savings also become handy to cope with the unexpected events like theft, fires, accidents and stock outs among many others.

2.2.5 Asset accumulation

This refers to increase in value of financial property and investments over time through the process of saving money and earning returns. It also includes purchasing of assets that add value in business. SMEs sometimes borrow loans from MFIs to purchase capital assets like welding machines, farm equipments, cookers, beauty salon equipments among many other fixed assets that SMEs would use in carrying out their business.

15

2.3 Empirical Review

Obli (2011) pointed that MFI services have enabled SMEs to develop their businesses through business diversification, increase of profits, high sales turnover, increased capital base accumulation of assets and lessening of poverty among entrepreneurs. The end result indicates that access of credit is influenced by guarantee, exposure of the entrepreneur, age and the size of a business. In conclusion, through this study it was established that most businesses rely on bank loan for business expansion. Small businesses are mostly supported by loans advanced by MFIs. Due to certain limitations like high interest rates, short grace period, moral hazard, small businesses fail to repay bank loan. In regard to the findings, it was recommended that in order for the economy of the country to grow, MFIs should increase credit and enhances participation in SMEs financing.

Koech (Koech, (2011) indicated that the services of microfinance institutions to majority of citizens in developing countries have enabled SMEs to create opportunities, manage scarce resources efficiently, embrace the idea of saving and avoid exposing themselves to risk by identifying areas to invest in and gain returns. Chijoriga(2000) indicated that access to capital, cost, capital market, collateral requirements, information access, capital management and cost of registration have been made easier by the microfinance institution.

According to Madole (2013) microfinance provide financial services to business people who lack access to banking and associated services. The approach to providing these services is through lending of micro loans to the poor mostly in the rural areas at

affordable interest rates. The loans are serviced in regular payment and no collaterals are required at the time of lending process. More often than not borrowers are required to form groups of a certain number to qualify for loans. This is a strategy by microfinance institution to reduce risk of defaulting. Apparently most microfinance services are tailored to meet the demands of most susceptible groups in the world like women.

SMEs borrow investment capital and they use it for the purpose in which they borrowed for, most of them do not have other means to raise funds other than from MFIs and they consistently rely on this institutions for financial services all the time they are in operation (Waithanji& Wakaba, 2014). Madole (2013) pointed that most entrepreneurs have adopted the culture of getting capital from MFIs, than the commercial banks because of the ease in MFI credit. More so as top up they also continue with the tradition of saving and taking loans from groups (Chamas) within the contest of SHGs.

2.4 Conceptual Framework

The conceptual framework includes independent and dependent variables. An independent variable is a variable whose variation does not depend on that of another while a dependent variable is a variable whose value depends on that of another. The strength of the relationship between a dependent and independent variables is called correlation. The dependent variable in this study is the financial performance of SMEs and the independent variables are the microfinance services (savings, loans, training and insurance)

Figure 2.1: Conceptual framework

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┌─────────────────────────┐          ┌─────────────────────────┐
│  -Saving Services       │          │                         │
│                         │          │                         │
│  -Loan Lending          │          │  Financial Performance  │
│                         │ ───────▶ │                         │
│  - Training services    │          │                         │
│                         │          │                         │
│  -Insurance services    │          │                         │
└─────────────────────────┘          └─────────────────────────┘
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Independent variables   **Dependent Variable**
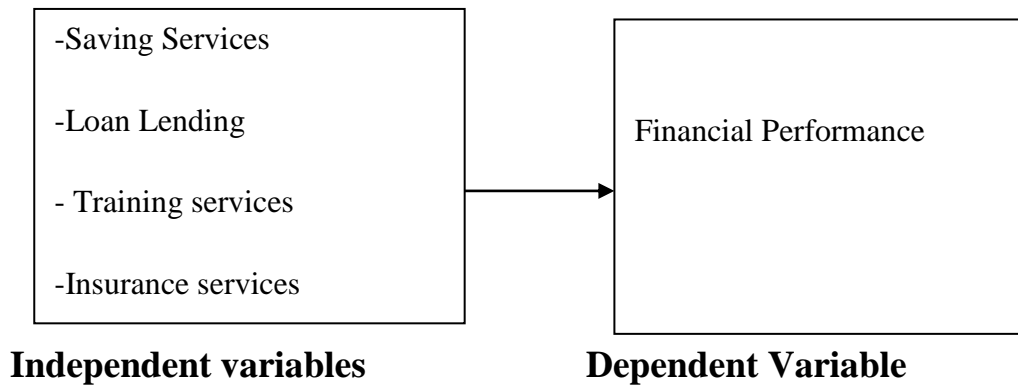
2.4 Summary of Literature review

Literature review sort to address the link between Micro financial services and financial performance of SMEs. The studies mostly indicate that MFIs are the best providers of financial service for those with low income and SMEs. The services contribute greatly in the reduction of poverty and growth of the economy encourages savings, protection against financial risks and accumulation of assets. All these services enhance greatly the financial performance of the involved stakeholders.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter presents the research methodology that was applied in conducting the study. It consisted the research design, population for the study, data compilation methods and data analysis.

3.2 Research Design

Creswell (2009) defines research design as an outline of how data was collected and analysed in pursuit of obtaining specific answers to research questions. The type of research design adopted was descriptive. A descriptive design explains the relationship that exit between variables (Kothari, 2005). This kind of design will be appropriate in establishing the relationship between microfinance services and financial performance of SMEs in Nairobi County with specific focus on SMEs in Kawangware Town.

3.3 Population

According to National Chamber of Commerce (2013), there were 708 active SMEs in Kawangware. The study will target these SMEs. The researcher chose the SMEs because he noted that most of them related or transacted with Microfinance institutions. Mugenda and Mugenda, (2003) indicates that the population targeted must comprise some traits that are observable and enable the researcher establish representative results of the whole study.

3.4 Sample Size

Random sampling method was used in coming up with the sample of the study. This sampling technique was applied to minimize sampling error as all elements in the target population have equal chances of being selected. Statistically, in order to generalize, a

sample of at least 30 elements should exist (Cooper and Schindler, 2003). Kotler (2001) indicates that 10% or more of the target population is a reliable sample for descriptive study. A sample of 72 SMEs was randomly selected out of the total population of 708; this represents 10.17% of the totals registered SMEs in Kawangware town.

3.5 Data Collection

Research questionnaire was used by the researcher to collect primary data for purposes of investigating the effect of Microfinance services on financial performance of SMEs in KawangwareTown. The questionnaire (appendix I) consisted of close-ended and prose questions. The questions that are close-ended provide more controlled replies to enhance concrete suggestions. The prose questions were used to capture more information that might have not been disclosed in the questions that are close-ended. The questionnaire had three major parts namely, background information of the respondent, information about the business and Microfinance services. The use of closed ended questions was for purposes of assessing the rating of a range of elements. The research variables were measured using ordinal scale. The five point ordinal scales are: Strongly Disagree (1) Disagree (2) Fairly Agree (3) Agree (4) Strongly Agree (5) The questionnaire will be administered using a drop and pick later method.

3.6 Data Analysis

The data was analyzed using descriptive method where frequency tables, crosstabs, pie charts and bar charts were used to represent the data analyzed. The researcher used SPSS version 16 to analyze the relationship between financial performance of SMEs and microfinance services (savings, loans, training and insurance).

<h1 style="text-align:center">CHAPTER FOUR</h1>

<h1 style="text-align:center">DATA PRESENTATION, ANALYSIS, AND DISCUSSSION</h1>

4.0 Introduction

This chapter presents data findings on the effect of microfinance services on financial performance of SMEs in kawangware. The analysis is aimed at determining the relationship that exists between microfinance services and financial performance. The data used is a primary obtained through questionnaires issued to SMEs in kawangware town randomly in the month of October 2016.The analysis of the data was done using statistical package for social sciences (SPSS version 16). The results of the analysis are shown as below.

4.1 Background information of the respondents

Table 4.1: case processing summary

	Cases					
	Valid		Missing		Total	
	N	Percent	N	Percent	N	Percent
respondent's gender designation at the business form of business	60	83.33%	12	16.67%	72	100.0%

From the table a total of 72 respondents were interviewed through the questionnaires and 83.33% responded while 16.67% did not. This shows the sample was representative and thus could be relied on for decision making. The analysis was based on the respondents who responded to the interviews.

Table 4.2 respondent's gender

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Male	45	62.5	62.5	62.5
	Female	27	37.5	37.5	100.0
	Total	72	100.0	100.0	

It can be observed that out of the 72 respondents interviewed, 62.5% were male and 37.5% female. This shows that the sample was a good representative of the gender. The table also shows that males are in SMEs businesses than females.

Table 4.3: Designation at the business

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	manager	25	34.72	34.72	34.72
	owner and manager	47	65.28	65.28	100.0
	Total	72	100.0	100.0	

From the table above it can be observed that out of the 72 respondents interviewed, 34.72% were managers or employees of businesses while 65.28% were business owners who managed their own businesses.

22

Table 4.4: The age bracket

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	under 30 years	20	27.77	27.77	27.77
	31-40years	15	20.83	20.83	48.60
	41-50 years	21	29.17	29.17	77.78
	over 50 years	16	22.22	22.22	100.0
	Total	72	100.0	100.0	

Of all the people interviewed, 27.77% were under the age of 30 years, 20.83% were between 31 to 40 years, 29.17% were between 41 to 50 years and 22.22% were over 50 years of age. This was based on the frequency with which they responded to questions. The graph below represents the information.

4.2 Information about the business

Table 4.5: Forms of business

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	sole proprietor	40	55.55	55.55	55.55
	Partnership	23	31.94	31.94	87.49
	registered company	9	12.51	12.51	100.0
	Total	72	100.0	100.0	

From the frequency table above 55.5% of the respondents interviewed, were sole proprietors while 31.94% of businesses were partnerships and 12.51% were registered

companies. This shows most of the businesses operated were sole proprietors followed by partnerships then registered companies.

Table 4.6 the period of business operation

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	under 5 years	21	29.16	29.16	29.16
	6-10 years	33	45.83	45.83	74.99
	11-15 years	11	15.28	15.28	90.27
	over 16 years	8	11.11	11.11	100.0
	Total	72	100.0	100.0	

From the table above its clear that the length of business operations varies from one business to another where 29.16% of the businesses were in operation for 5 or less years. 45.83% businesses were in operation for 6-10 years, 15.28% were in operation for 11-15 years and 11.11% of the respondents operated the business for over 16 years.

Table 4.7: The number of employees

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	under 3 Employees	45	62.5	62.5	62.5
	4-6 Employees	18	25	25	87.5
	7-9 Employees	5	6.9	6.9	94.4
	over 10 Employees	3	4.6	4.6	100.0
	Total	72	100.0	100.0	

24

From the table it is clear that 62.5% of the businesses employs less than 3 employees, 25% of the businesses employed 4-6 employees, 6.9% of the businesses employs 7-9 employees and 4.6% of the businesses employs over 10 employees. Thus it can be concluded that most SMEs are characterized by fewer employees.

Table 4.8 Source of business capital

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	personal savings	39	54.17	54.17	54.17
	loan from microfinance	21	29.17	29.17	83.34
	loan from a bank	8	11.11	11.11	94.45
	Liquidation	4	5.55	5.55	100.0
	Total	72	100.0	100.0	

From the table it's evident that 54.17%, 29.17%, 11.11% and 5.55S% of the business capital sources comes from personal savings, loan from microfinance, loan from banks and liquidation respectively. Thus we conclude that most of the business capital for SMEs comes from personal savings followed by loans from banks and microfinance institutions.

4.3 Microfinance services

4.3.1 Microcredit

Table 4.9: Relationship between microcredit and business capital

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	strongly disagree	13	18.06	18.06	18.06
	disagree	12	16.7	16.7	34.76
	fairly agree	15	20.83	20.83	55.59
	Agree	20	27.78	27.78	83.3S
	strongly agree	12	16.7	16.7	100.0
	Total	72	100.0	100.0	

The table above tried to research whether microcredit has led to an increase in business capital and 34.76% disagreed with the assumption that microcredit led to an increase in business capital while 63.24% agreed with the assumption. Thus it can be agreed that the microcredit causes an increase in business capital for the SMEs.

Table 4.10: Relationship between microfinance and business liquidity position

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	strongly disagree	13	18.06	18.06	18.06
	disagree	12	16.7	16.7	34.76
	fairly agree	15	20.83	20.83	55.59
	Agree	22	30.55	30.55	86.15
	strongly agree	10	13.89	13.89	100.0
	Total	72	100.0	100.0	

From the table we sought to verify the assumption that micro credit has improved the business liquidity position. From the table it can noted that 34.76% of the respondents either strongly disagreed or disagreed while 65.24% agreed either fairly, strongly or just agreed. This shows that 65.24% of the SMEs acknowledge that microcredit has improved the business liquidity position.

Table 4.11: Relationship between microcredit and asset accumulation

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	strongly disagree	9	12.5	12.5	12.5
	disagree	24	25.0	25.0	37.5
	fairly agree	12	16.7	16.7	54.2
	Agree	21	29.2	29.2	83.3
	strongly agree	12	16.7	16.7	100.0
	Total	72	100.0	100.0	

The table tries to prove the hypothesis that micro credit has led to an increase in asset accumulation where 37.5% either strongly disagree or agree while 62.5% agree either strongly, fairly or just agreed. Thus there strong evidence that shows that microcredit has led to an increase in asset accumulation

Table 4.12: Relationship between microcredit and risk coping

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	strongly disagree	9	12.5	12.5	12.5
	disagree	15	20.8	20.8	33.3
	fairly agree	21	29.2	29.2	62.5
	Agree	15	20.8	20.8	83.3
	strongly agree	12	16.7	16.7	100.0
	Total	72	100.0	100.0	

The table verifies the assumption that micro credit has made coping with risk easier. From the table it can be seen that there is 33.3% prove that the micro credit hasn't made it easier for risk coping easier while 66.7% support that microcredit has made easier for SMEs to cope with risk.

Table 4.13: Relationship between microcredit and income fluctuations

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	strongly disagree	6	8.3	8.7	8.7
	Disagree	21	29.2	30.4	39.1
	fairly agree	12	16.7	17.4	56.5
	Agree	21	29.2	30.4	87.0
	strongly agree	9	12.5	13.0	100.0
	Total	69	95.8	100.0	
Missing	System	3	4.2		
Total		72	100.0		

From the table above its clear that 39.1% disagree with the proposition that microcredit has led to protection in income fluctuation and maintained consumption levels while 60.9% agree with the proposition. Thus microcredit leads to protection in income fluctuations and maintains consumption levels for SMEs businesses.

4.3.2 Training

Figure 4.1: Relationships between training and business capital

training and business capital
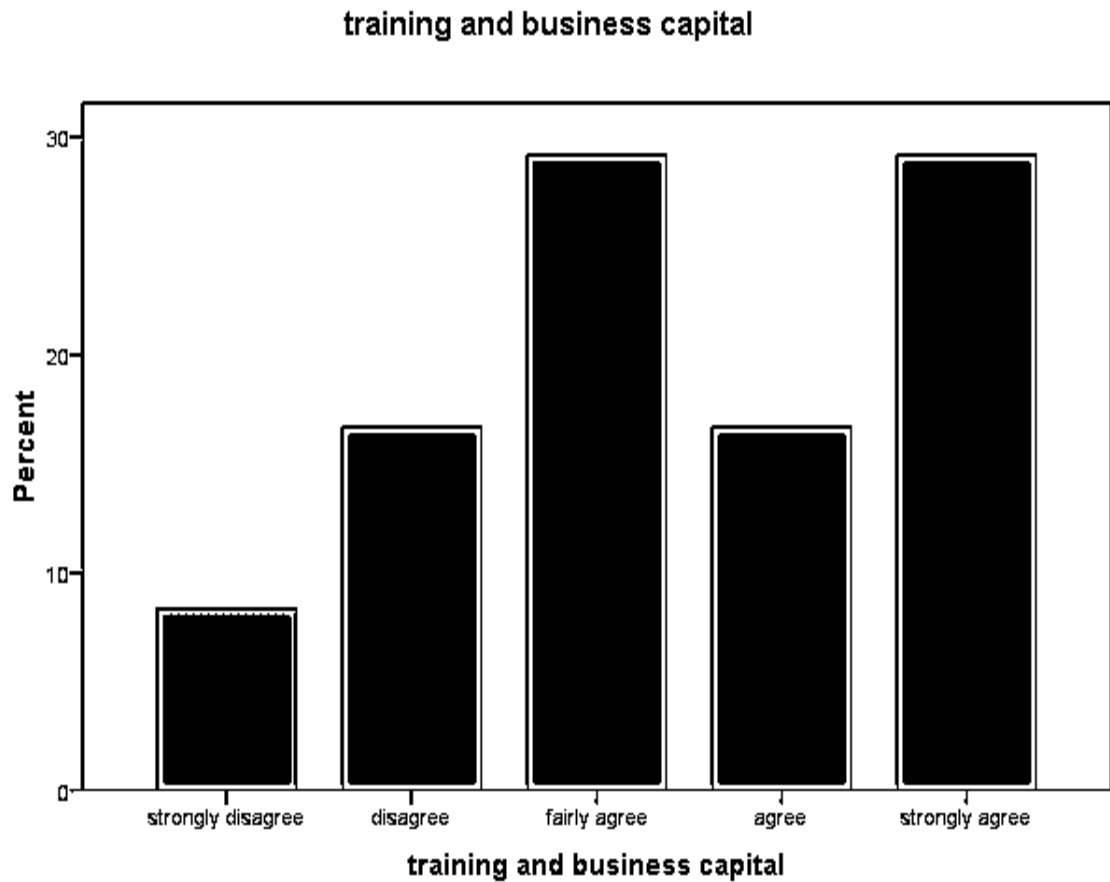
From the graph above its clear that a large proportion of business people agree that business capital is influenced by the level of training on managing businesses.

Figure 4.2: Relationships between training and liquidity position

training and liquidity position
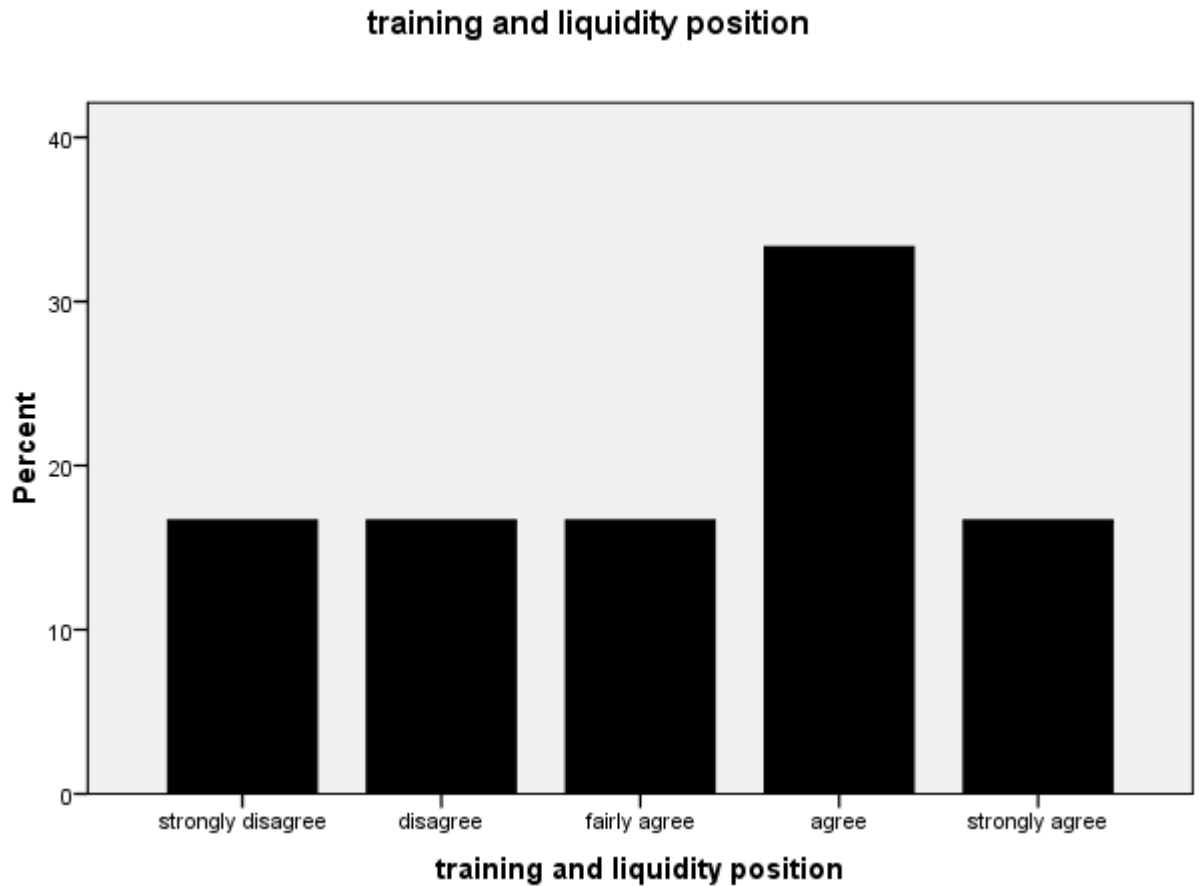
The graph above shows the relationship between training and liquidity position where it's clear that training has led to an improved business liquidity position since large proportion of business agree with the assumption that training has improved the business liquidity position.

Figure 4.3: Micro Credit and Income Fluctuations

micro credit and income fluctuations
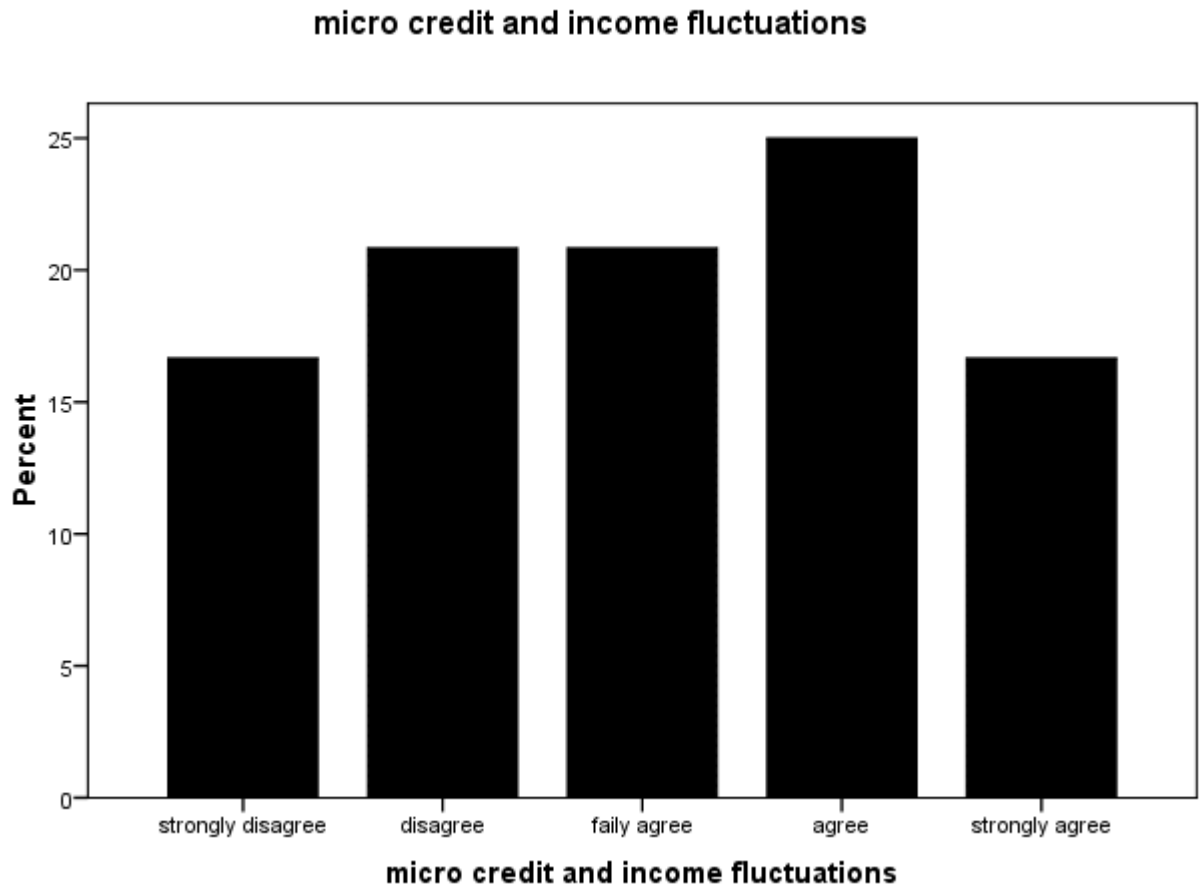
The graph above depicts that business training has marginally led to protection in income fluctuations and has maintained the consumption levels. Thus from the graphs above its clear that business training has a significant positive influence on the SMEs activities

4.3.3 Micro saving

Table 4.14: relationship between micro saving and business capital

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	strongly disagree	9	12.5	12.5	12.5
	Disagree	12	16.7	16.7	29.2
	fairly agree	18	25.0	25.0	54.2
	Agree	21	29.2	29.2	83.3
	strongly agree	12	16.7	16.7	100.0
	Total	72	100.0	100.0	

From the table above it can be noted that micro savings influences the business capital positively that is only 29.2% of the respondents disagree that micro savings has led to an increase in business capital while 70. 8% agree that micro savings has led to an increase in business capital. Thus it can be concluded that there is significance evidence that micro savings has led to an increase in business capital for SMEs.

Table 4.15: relationship between micro saving and business liquidity position

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	strongly disagree	12	16.7	16.7	16.7
	Disagree	12	16.7	16.7	33.3
	fairly agree	15	20.8	20.8	54.2
	Agree	21	29.2	29.2	83.3
	strongly agree	12	16.7	16.7	100.0
	Total	72	100.0	100.0	

The table shows the relationship between micro savings and business liquidity position. It can be observed that that there substantive evidence that micro savings has improved the business liquidity position of the SMEs as 67.7% of the respondents supports the argument. While only 33.3% disagrees.

Table 4.16: relationship between micro saving and asset accumulation

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	strongly disagree	9	12.5	12.5	12.5
	Disagree	18	25.0	25.0	37.5
	fairly agree	12	16.7	16.7	54.2
	Agree	21	29.2	29.2	83.3
	strongly agree	21	16.7	16.7	100.0
	Total	72	100.0	100.0	

The table above proves that 62.5% of the businesses assets accumulation increase has been brought by micro savings while only 37.5% refutes the claim. Thus supports that a large proportion of the business assets accumulation has been brought about by micro savings.

Table 4.17: relationship between micro saving and risk coping

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	strongly disagree	12	12.5	12.5	12.5
	Disagree	15	20.8	20.8	33.3
	fairly agree	21	29.2	29.2	62.5
	Agree	15	20.8	20.8	83.3
	strongly agree	12	16.7	16.7	100.0
	Total	72	100.0	100.0	

From the frequency table above its clear that micro savings has made risk coping easier for the business since 67.3% of the respondents agree with the argument that micro savings lead to easier risk coping for businesses.

Table 4.18: Relationship between micro saving and income fluctuations

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	strongly disagree	9	12.5	12.5	12.5
	Disagree	21	29.2	29.2	41.7
	fairly agree	12	16.7	16.7	58.3
	Agree	21	29.2	29.2	87.5
	strongly agree	9	12.5	12.5	100.0
	Total	72	100.0	100.0	

 From the table above its clear that there is a relative chance that micro savings has led to protection in income fluctuation and maintains the consumption level. Since 58.3% of the respondents are in agreement with the proposition while 41.7% rejects the assumption. From the discussion it can be concluded that micro savings have positive implications to the business.

4.3.4 Insurance service

The diagrams below show the relationship between insurance services and business activities.

Figure 4.5 Relationship between insurance service and business capital

insurance service and business capital
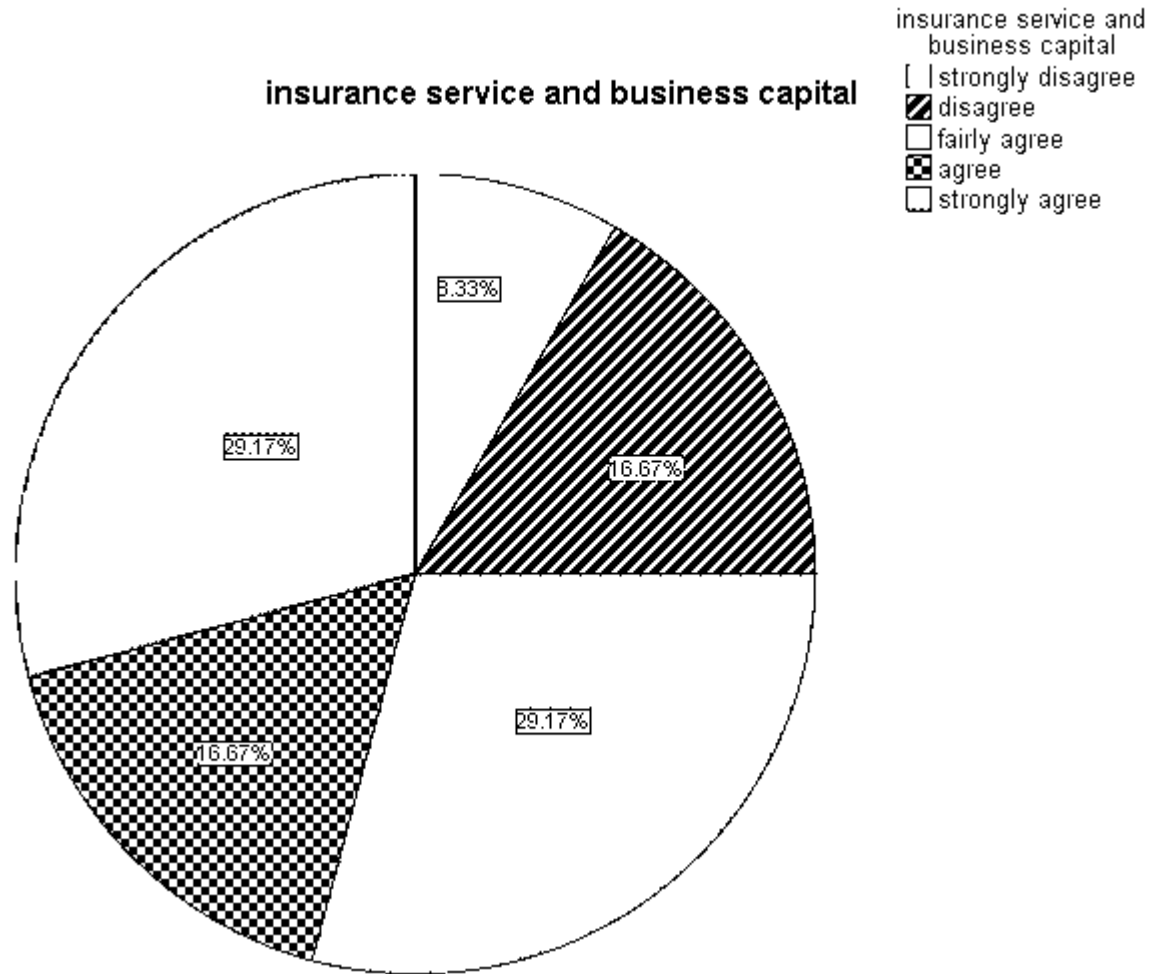
The piechart above shows the relationship between insurance services and business capital. It can be concluded that the insurance services have led to an increase in business capital since only an aggregate of 25% of the respondents disagree with the argument while 75% agree with the assumption.

Figure 4.6 Relationship between insurance services and business liquidity

insurance service and liquidity position
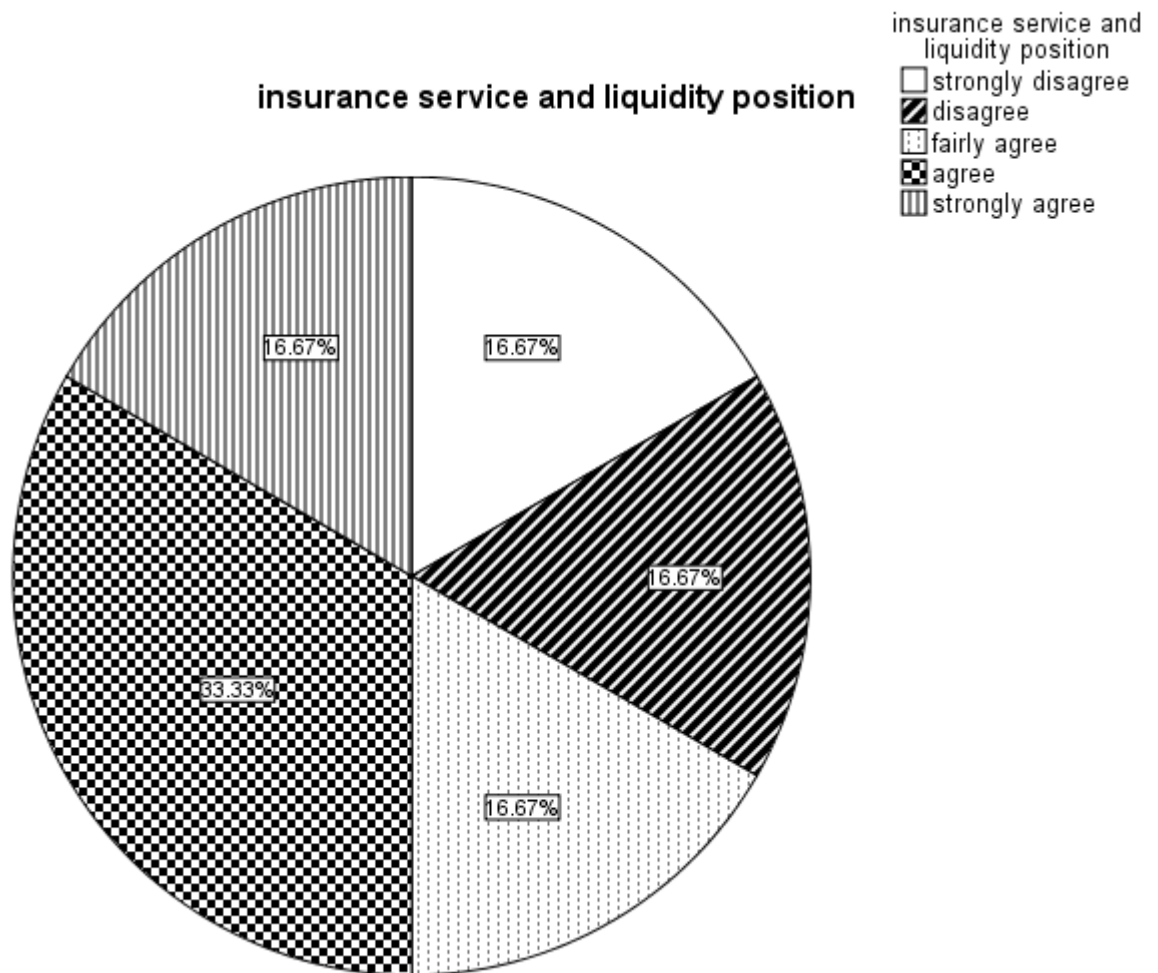
The pie chart above shows that an aggregate of 33.3% disagrees with the statement that insurance service has led to improved business liquidity position while 66.7% agree either strongly fairly or just agreeing. The conclusion is that insurance services have improved business liquidity position.

Figure 4.7 Relationship between insurance services and asset accumulation

insurance service and asset accumulation

12.50%
16.67%
16.67%
16.67%
37.50%

insurance service and
asset accumulation
☐ styrongly disagree
▨ disagree
▦ fairly agree
▩ agree
▥ strongly agree
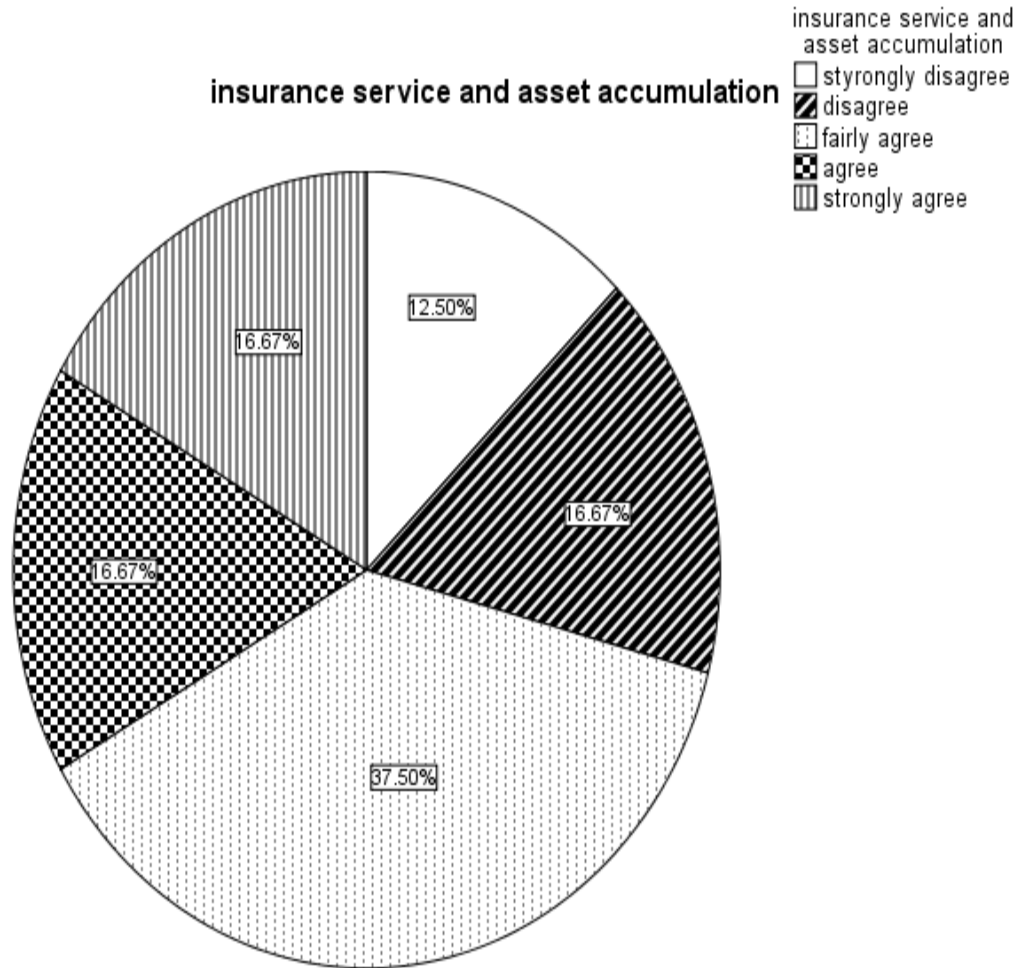
The pie chart above tries to represent the relationship between insurance service and asset accumulation. It is therefore clear that an aggregate of 70.93% agreed that insurance services have led to an increase in asset accumulation, thus we conclude that insurance service has led to an increase in asset accumulation.

Figure 4.8 Insurance service and risk coping

insurance service and risk coping

insurance service and risk coping
☐ strongly agree
▨ disagree
▦ fairly agree
✖ agree
⦀ srongly agree

16.67%
25.00%
20.83%
12.50%
25.00%
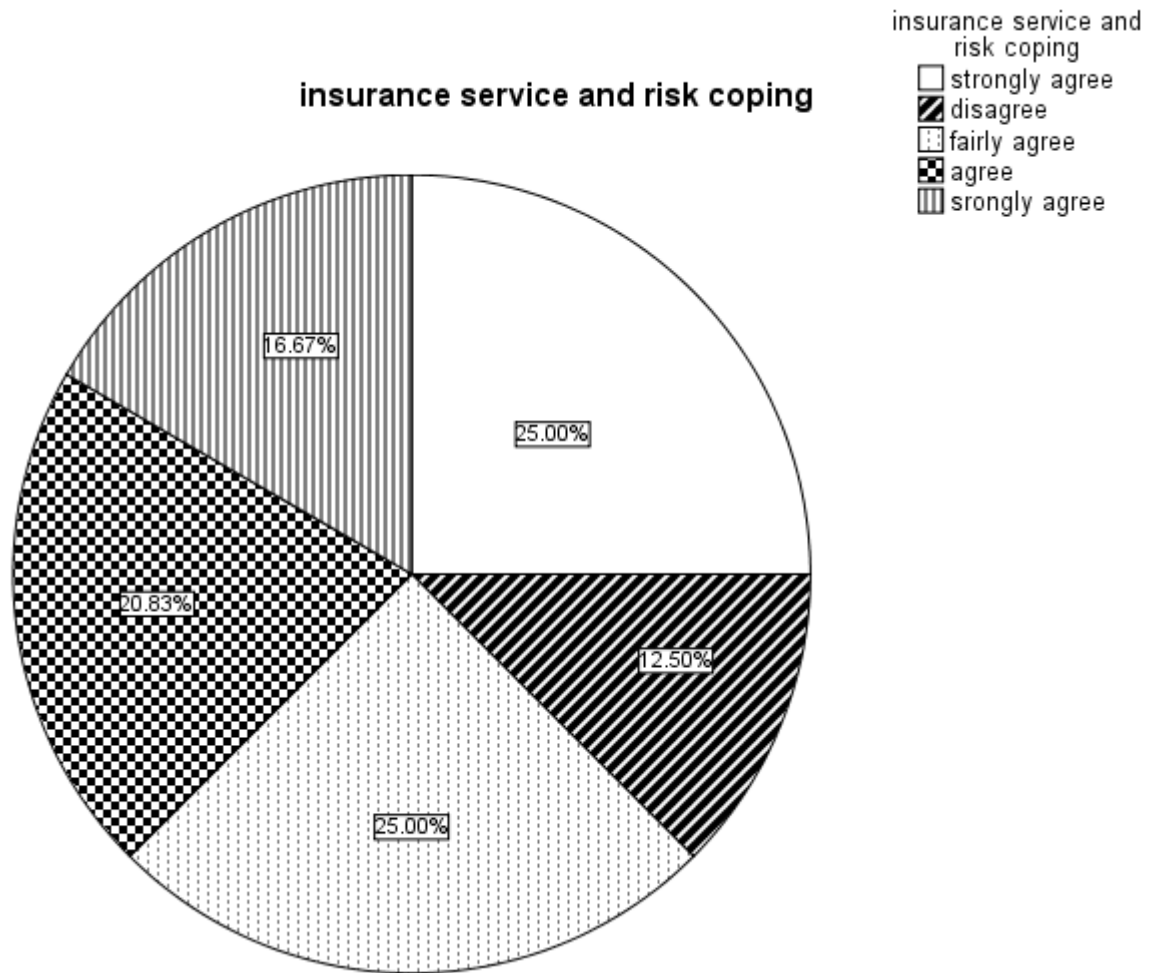
From the pie chart above   an aggregate of 37.5% respondents disagreed with the argument insurance services has made coping with with the business risk easier while 62.5% agrees with the argument. Thus we conclude that insurance services has made easier for businesses to cope with the risk.

Figure 4.9: Relationship between insurance services and protection of income fluctuations
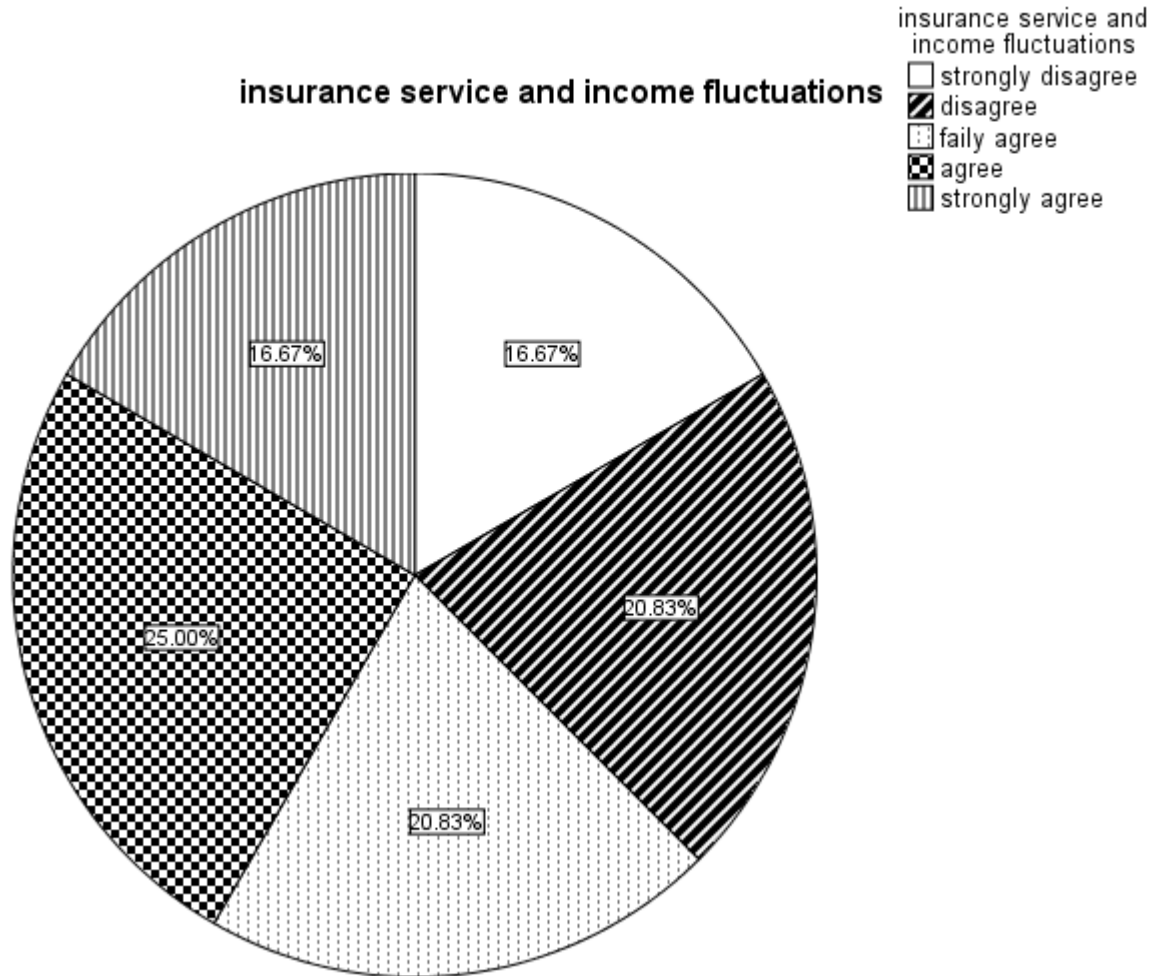
The chart above shows the relationship between insurance service and protection of income fluctuations and maintaining consumption levels. It can be observed that an aggregate 36.5% disagree proposition while 63.5% of the respondents agree with the argument. We therefore conclude that insurance services has led to income protection and maintained the consumption levels.

From the charts above we can conclude that insurance service has positive influence on the business activities.

4.4 Summary of the chapter

From the analysis above it can be concluded that after putting all the variables into consideration there is sufficient reasons to support that there exists a relationship between micro financial services such as loans, trainings, saving and insurance services and financial performance of SMEs as supported by the case study of SMEs in kawangware.

CHAPTER FIVE
SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter presents discussions of the key findings presented in chapter four, conclusions drawn based on such findings and recommendations for policy and practice. This section also presents the suggestions for further research.

5.2 Summary

The objective of this research was to study and establish the effect of microfinance services on financial performance of SMEs in Kawangware town, Nairobi County. The effect was to be measured by the access to business capital, increase of business liquidity, asset accumulation, protection in income fluctuation and management of risks.

Access to business capital is a competitive advantage to SMEs. It enables business to grow their business by either increasing the size of business or diversifying their investment portfolios. Enabling business to accumulate capital is the most direct effect of microfinance services. Productive or fixed assets acquired are economic resources that enable business gen erate revenue. It was evident from the study that microfinance services improve the business liquidity position that enables business to increase sales, asset base and minimizes risks. Microfinance services protect SMEs against income fluctuations. This enables business people to maintain their expenditures without interfering with the normal operations of the business.

The study revealed that credit has improved the financial performance of SMEs. The access to credit enabled SMEs to engage in income generating business and improve the owners' living standards. Most SMEs confirmed that credit had improved their financial performance. The study also showed that savings had an effect on financial performance of SMEs. It enhances acquisition of assets and also mitigates risks that SMEs are exposed to. Most respondent confirmed that it improved their financial performance.

Insurance services also improved financial performance of SMEs this was confirmed by the respondents during the study. Some did not agree that the service contributed to positive financial performance but a good number confirmed the positive effect on their financial performance. It also insulated them against adversities, hence stability of the business. Training exposes relevant skills to trainees. The analysis of the data obtained showed that most SMEs indicated that training had exposed them to skills on how to run their business profitably.

The overall analysis of the data obtained revealed that there is a substantial effect of microfinance services on the financial performance of SMEs. It is confirmed that sustainable or consistent microfinance services enables SMEs to build stable business and improve their financial performance in general.

5.3 Conclusion of the study

It has been established that microfinance services have a positive effect on all the variables that operationalized financial performance of SMEs. The variables include:

Business capital. Liquidity, asset accumulation, risk management and protection against income.

The analysis shows that most SMEs confirmed that microfinance services improved their financial performance. However, a fair number of respondents disagreed that microfinance service had a positive effect on their financial performance. MFIs should note that their services are improving the performance of most of the entrepreneurs but put in place strategies to market their service more aggressively.

5.4 Recommendation

The researcher recommends that the government and the MFIs regulating bodies should support the MFIs to facilitate their growth and increase in capacity. It is through this support that MFIs can be able to reach more SMEs , especially those who cannot access financial services in conventional banks It is also critical to interview more entrepreneurs instead of have a few of them.

5.6 Limitations of the study

Most of the targeted respondents insisted that they were too busy to fill the questionnaire. It took a lot of time to request them to fill the questionnaire. Time constraints is another limitation - the study was cross-sectional; a longitudinal study can give more insight. A few of the respondents did not respond to the questionnaire.

5.7 Recommendation for further study

The future research can be replicated in other towns in Kenya and other countries to find out the effect of microfinance services on financial performance of Small and Medium Enterprises.

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APPENDIX I: QUESTIONNAIRE

SMEs questionnaire

This questionnaire is for the purpose of research only. N.B:DO NOT WRITE YOUR NAME ANYWHERE; THE RESPONDENTS' IDENTITY SHALL BE ABSOLUTELY CONFIDENTIAL. Please tick (√) in the appropriate bracket or fill in the information of your response to all the following questions.

PART A: BACKGROUND INFORMATION OF THE RESPONDENTS

1. What is your gender?
   a) Male   ( )
   b) Female   ( )
2. What is your designation at the Business?
   a) Manager (Employee)   ( )
   b) Owner and Manager   ( )
3. What is your age bracket?
   a) Under 30 years   ( )
   b) 31- 40 years   ( )
   c) 41 – 50 years   ( )
   d) Over 50 years   ( )

SECTION B: INFORMATION ABOUT THE BUSINESS.

1. What is the form of the business?
   a) Sole proprietorship   ( )
   b) Partnership   ( )
   c) Registered Company   ( )
2. For how long have you run/operated the business?
   a) Under 5 years   ( )
   b) 6 - 10 years   ( )
   c) 11 - 15 years   ( )
   d) Over 16 years   ( )
3. Kindly indicate the number of employees the business has
   a) Under 3 Employees   ( )
   b) 4 - 6 Employees( )
   c) 7 - 9 Employees   ( )
   d) Over 10 Employees   ( )

4. What was your initial source of capital when starting the business?
    a) Personal savings   ( )
    b) Loan from Microfinance Institution   ( )
    c) Loan from a Bank   ( )
    d) Contribution from friends and/or family members ( )
    e) Liquidation i.e. selling of personal assets( )

SECTION C: Microfinance Services. Using the rating scales bellow, please indicate the extent you agree with the statements relating to your business. The scales are: 1. Strongly Disagree 2 Disagree 3. Fair Agree 4. Agree 5. Strongly Agree.

I) MICRO-CREDIT (LOAN)

		1.Strongly Disagree	2.Disagree	3.Fairly Agree	4.Agree	5.Strongly Agree
1.	Micro-credit has led to an increase in business capital					
2.	Micro-credit has improved the business liquidity position					
3	Micro-credit has led to an increase in asset accumulation					
4	Micro-credit has made coping with risk easier.					
5	Micro- credit has led to protection in income fluctuation and maintained consumption levels.					

II) TRAINING

		1.Strongly Disagree	2.Disagree	3.Fairly Agree	4.Agree	5.Strongly Agree
1.	Training has led to an increase in business capital					
2.	Training has improved the business liquidity position					
3	Training has led to an increase in asset accumulation					
4	Training has made coping with risk easier.					
5	Training has led to protection in income fluctuation and maintained consumption levels.					

III) MICRO-SAVINGS

		1.Strongly Disagree	2.Disagree	3.Fairly Agree	4.Agree	5.Strongly Agree
1.	Micro-Saving has led to an increase in business capital					
2.	Micro-Saving has improved the business liquidity position					
3	Micro-Saving has led to an increase in asset accumulation					
4	Micro-Saving has made coping with risk easier.					
5	Micro- Saving has led to protection in income fluctuation and maintained consumption levels.					

IV) INSURANCE SERVICE

		1.Strongly Disagree	2.Disagree	3.Fairly Agree	4.Agree	5.Strongly Agree
1.	Insurance service has led to an increase in business capital					
2.	Insurance service has improved the business liquidity position					
3	Insuranceservice has led to an increase in asset accumulation					
4	Insurance service has made coping with risk easier.					
5	Insurance service has led to protection in income fluctuation and maintained consumption levels.					

V. Can you recommend to an entrepreneur the financial services offered by MFIs?
…...Please explain ……………………………………………………………

VI. What are other services do you think MFIs can offer to enhance financial performance of SMEs?

VII. Briefly explain why you prefer MFIs services to those offered by other financial institutions.

APPENDIX II: LIST OF MICRO FINANCE INSTITUTIONS IN KENYA

1) AAR Credit Services

2) Adok Timo

3) Agakhan First Micro Finance Agency

4) Biashara Factors Ltd

5) Bimas

6) Blue Limited

7) Canyon Rural Credit Ltd, Nairobi

8) Elite Micro Finance

9) Faulu Kenya Limited

10) Fusion Capital Ltd, Nairobi

11) Jamii Bora Bank

12) Jitegemea Credit Scheme

13) Juhudi Kilimo Company Limited

14) K-Rep Advisory Services (Africa)

Ltd, Nairobi

15) Kadet Ltd, Nairobi

16) Kenya Eclof

17) Kwft. Kenya Women Finance Trust

18) Kenya Entrepreneur Empowerment

Foundation

19) M I C Micro Finance Ltd

20) Micro Africa Limited

21) Molyn Credit Limited

22) Oiko Credit

23) Opportunity International

24) Pamoja Women Development

Programm

25) Platinum

26) Renewable Energy Technology

Assistance Programme

27) Rupia Ltd

28) Sisdo

29) Smep Limited (Small And Micro

Enterprise Programme)

30) Swiss

31) Taifa Option Microfinance

32) W E E C

33) U & I Microfinance

34) Yehu Microfinance Trust