THE EFFECTIVENESS OF MICROFINANCE INSTITUTIONS IN FINANCIAL INCLUSION: THE CASE OF MFIs IN NAIROBI

BY:

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DECLARATION

This Project is my original work and has not been presented in any other University.

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

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DEDICATION

I would like to dedicate this Project to the loving memory of my late mother and father Chinda Sarday Rojay and Paye Whornee (GBAR-PAYE WHEAYE) who were so committed to my education. And also to the honor of my parents Mr. & Mrs. S. Eugene Watkins who generously supported me in my drive for higher education. Mother Barbie, thank you for your prayers and concerns for me and my love to you all.

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ABSTRACT

The objective of the study is to examine the effectiveness of microfinance institutions in implementing financial inclusion in Nairobi. Accordingly, characteristics of MFIs which constitute effectiveness were assessed to determine the extent to which these financial institutions contributed to financial inclusion with specific reference to MFIs operating in Nairobi.

The study adopted the descriptive research method to examine the role of MFIs in Financial inclusion in Nairobi. Both quantitative and qualitative approaches to data analysis were employed. The target population comprised the 47 registered MFIs (AMFI-K, 2011) operating in Nairobi. The census survey method was applied and primaiy data was collected using questionnaire. Data was analyzed using other descriptive tools such as percentages and frequency distributions.

Findings from the research indicate that MFIs adopted various methods in promoting financial inclusion in Nairobi such as the targeting of traders and farmers who make up bulk of the population and often excluded financially by the formal sector, the use of credits and savings as key financial products that are critical to empowerment as the first step towards financial inclusion, balancing their operations as commercial, NGOs or Government programs to meet the financial needs of people at different levels, the use of savings as one of major sources of capital especially for those operating on commercial basis to reduce dependence on borrowings, use of cumulative savings and ability to pay as basis for lending to guard against the risk of defaults, levying of reasonable and affordable interest rates as well as flexible payment periods to ease constraints on those taking loans. The study further revealed that the need for MFIs products vary from product to product with very strong need for working capital on the credit side and very strong need for savings accounts on the savings side. The outcome of the study was overwhelmingly favorable as 85% of MFIs products meet customers' expectations. This outcome is an indication of how effective MFIs can be in promoting financial inclusion. The government, donors and private investors should therefore increase their financial supports to MFIs since these institutions possess the requisite ability and are well positioned to reach out to the poor who are the prime target for financial inclusion. MFIs should also diversify their

credit products and further reduce borrowing constraints to ensure that they serve a broader spectrum of clients as means of promoting greater inclusion in to the financial system.

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ABBREV IATIONS AND ACRONYMS

AFI	Alliance of Financial Inclusion
AMFI	Association of Microfinance Institutions
ASCAs	Accumulating Savings and credit Associations
CBK	Central Bank of Kenya
CGAP	Consultative Group to Assist the Poor
FI	Financial Inclusion
FinAccess	Financial Access
FSAs	Finance and Savings Associations
FSD	Financial Sector Deepening
GPFI	Global Partnership for Financial Inclusion
GOK	Government of Kenya
KADET	Kenya Agency for Development and Enterprises Technology
MFIs	Micro Finance Institutions
NGOs	Non-Governmental Organizations
POSB	Post Office Savings Bank
PRSP	Poverty Reduction Strategy Paper
ROSCAs	Rotating savings and credit Associations

SACCOs	Savings and Credit Cooperatives
SHGs	Self-Help Groups
WCGs	Welfare/Clan Groups

CHAPTER ONE

INTRODUCTION

1.1. Background of the Study

Financial inclusion has been placed at the forefront of many policymakers' agenda, both at the national level and through standard-setting bodies such as the Group of industrialized Countries, G20. There is also a growing list of countries that have specific financial inclusion policy mandates that reach across different government ministries and agencies (Reyes, Aliain, Mazer, 2011). By prioritizing financial inclusion and putting policies into action through new programs and reforms, several countries in the developing world including Kenya are now playing leading roles in providing access to financial resources to their citizens **(FSD** Kenya, 2009). They have adopted policies that include the expansion of branchless banking across regions in their individual countries. This has been done primarily through third-party agents as well as the use of financial education courses which are administered through national school systems, improved financial consumer protection for low-income populations and the development of new delivery channels (Mwatela, 2008). Several practical financial inclusion efforts are also being initiated by governing authorities or financial regulators with focus on the development of strategies through the collection of data, indicators, and analytical tools that will help monitor changing financial inclusion landscapes in those countries. The focus is also on how to effectively use the data to change policies and target sectors and communities that are underserved or marginalized (Roodman, 2011).

In its development strategy, Vision 2030, Kenya is also striving to become a regional financial center with vibrant, efficient and globally competitive financial system to drive savings and investments. This, crafters of the policy document believed, will lead to a high and sustainable, but also broad-based economic growth. There is also the growing recognition in the current body of knowledge that increasing access to financial services has both private and social benefits. In addition to enhancing efficiency and stability, Vision 2030 identifies the need to increase access to affordable financial services and products for a wider section of Kenyans, particularly the poor, low-income households and small- and medium- scale enterprises (SMEs). Poor and low-income households in informal urban settlements, small and micro-level businesses, rural areas, and women are therefore prioritized in the new vision for financial sector development (Financial Inclusion Kenya, 2009).

The policy is being conducted through various financial institutions within both the formal and informal Financial sectors. One group of financial institutions traditionally known for exercising the responsibility of reaching to the poor and low income earners are the microfinance institutions (MFIs). According to Barman, Mathur, Kalra (2009) the functional intervention of microfinance institutions is an important component of development strategy to mainstream the poor with the formal financial system. They noted that microfinance as financial services for the poor may not solve all the problems caused by poverty but can help put resources and power into the hands of poor and low-income people and allow them make financial decisions and chart their own paths out of poverty. They concluded that MFIs have great potential but at the same time with enormous challenges.

1.1.1 Financial Inclusion

Rangarajan (2008) gave a broad working definition of financial inclusion as the process of ensuring access to financial services, timely and adequate credit where needed by vulnerable groups such as weaker sections and low income groups at an affordable cost. He further described the essence of financial inclusion as ensuring of a range of appropriate financial services that is available to every individual which enable them to understand and access those services. Apart from the regular form of financial intermediation, financial inclusion may include a basic banking account for making and receiving payments, savings product suited to the pattern of cash flows of a poor household, money transfer facilities, small loans and overdrafts for productive, personal and other purposes as well as life and non-life insurance, etc.

The Center for Financial Inclusion (CFI) also defines financial inclusion as a state in which all people who can use them have access to a full suite of quality financial services, provided at affordable prices, in a convenient manner, and with dignity for the clients (Gardeva, Rhyne, 2011). Reyes, Canote, Mazer (2010) further referred to financial inclusion as broad access to a portfolio of quality financial products and services which include loans, deposit services, insurance, pensions and payment systems, as well as financial education and consumer protection mechanisms.

Rangarajan (2008) state the objective of financial inclusion as the comprehensive inclusion that provides a holistic set of services encompassing access to financial services, timely and adequate credit where needed by vulnerable groups such as weaker sections and low income groups at an affordable cost. Some specific objectives are basic banking account for making and receiving payments, savings product suited to the pattern of cash flows of a poor household, money transfer facilities, small loans and overdrafts for productive, personal and other purposes as well as life and non-life insurance, etc.

Traditionally policymakers have been more focused on the soundness of the financial system itself, and providing the right incentives for financial institutions to engage in their business while taking into account and controlling their risk exposure. However, the emergence of country-level policy mandates around financial inclusion, coupled with new international initiatives such as the G20's Global Partnership for Financial Inclusion (GPFI), have brought considerable momentum to this topic. Nevertheless, the central challenge for policymakers seeking to improve financial inclusion within their countries is how to measure and monitor the impact of financial inclusion strategies on the levels of access and the types of financial services reaching their citizens.

This can be done by putting policies into place through new programs and reforms which include the expansion of branchless banking, primarily through third-party agents, financial education courses administered through school system or workshops and seminars, improved financial consumer protection for low-income populations and other delivery channels such as the microfinance institutions (MFIs). The development of new data, indicators, and analytical tools for monitoring changing financial inclusion landscape is also required to effectively use the data to change policies and target underserved sectors or communities which have often been the role of microfinance institutions. Policymakers can then use the information to measure progress in financial access. These measurements are used to track specific subject matter such as intra-country distribution of financial services and the correlation between financial access and social and economic development (Reyes, Allain, Mazer, CGAP, 2011).

1.1.2 The Role of Microfinance

The extent to which microfinance has been practiced in Kenya can be measured by the number of MFIs both formal and informal operating within the country. Compared to other African countries, Kenya has been permanently featured among countries of the world that are engaged in genuine effort in improving micro financing practices as exemplified by the number of research works that have been undertaken either alone or in close collaboration with other institutions, organizations or countries to develop frameworks intended to enhance microfinance practices and performances. But of greater significance is the level at which microfinance is reaching out to the poor, low income earners and owners of SMEs who do not have access to the formal sector due to capacity limitation posed by commercial and other formal banking institutions (KADET, 2005).

A determination of the performance of microfinance practices and its impact on the population can be made by reviewing the statistics of the period prior to introduction of the Poverty Reduction Strategy Paper (PRSP) and comparing same with statistics of current economic conditions of the poor and low income earners who are target of MFIs and microfinance practices in Kenya. As at 1997, over all poverty rate nationwide has risen from 43.8 percent in 1994 to 52.3 percent in 1997. This reflected the trend in rural areas, which saw an increase in the rate of poverty from 46.8 percent to 52.9 percent. It is an indication of a substantial increase in urban poverty between the two years which saw a rise from just fewer than 29 percent to over 49 percent thus changing the traditional view that poverty was predominantly a rural phenomenon ((Perspectives of the Poor on Credit and Extension Policies, Ministry of Planning and National Development, 2003)).

ft was estimated in the year 2000 (KADET, 2005) that 56 per cent of Kenyans lived below the poverty line, an equivalent of 17 million people out of 30 million. In response to the rising levels of poverty and deteriorating social conditions, the Government reiterated its commitment to tackling the situation through the development of its Poverty Reduction Strategy Paper (PRSP) to change the trend. The overall poverty line in Kenya was calculated by summing the food expenditure level thus placing the overall poverty line at Kes 1,239 per month per adult in rural areas and Kes 2,648 in urban areas by 1997 (GOK Report, 1988). According to FinAcess by 2009, there was a dramatic shift in the financial landscape of Kenya from 2006. There has been a significant jump in the proportion of formally included from 26.3% to 40.5%, mainly driven by the advent of mobile money transfers. A lesser but still impressive contributor to formal inclusion has been the banking sector, which pushed the banking population up by four percentage points from 18.5-22.6% while MFIs contribution to the effort was only at 3.4%, taking into account only registered MFIs (FinAccess, 2009).

1.1.3 The Microfinance Sector of Kenya

The microfinance sector in Kenya has grown over the years and now consists of a large number of competing institutions. They vary in formality, commercial orientation, professionalism, visibility, size, geographical coverage as well as legal status. These institutions range from informal organizations such as the Rotating Savings and Credit Associations (ROSCAs), Financial Services Associations (FSAs), savings and Credit Cooperative (SACCOs), NGOs, to commercial banks that are down saving (Aleke, 2003).

The Association of Microfinance Institutions of Kenya (AMFI-K) has 53 member institutions (see appendix 2) comprising of NGOs, companies, trusts, societies and commercial banks with 47 operating in Nairobi (AMFI-K, 2011). The AMFI-K is currently serving more than 6,500,000 poor and middle class families with financial services throughout Kenya. Twenty one of these are deposit taking microfinance institutions with 742 outlets, 2,494 staff and a loan portfolio of Kes 29 Billion, 1.1 million institution savers and 250,000 borrowers. A wide range of financial services are provided by the microfinance institutions: ranging from savings and credit facilities, money transfer and micro insurance to the economically poor, low income households and owners of small micro scale enterprises in both rural and urban areas, using innovative delivery methodologies and channels. They ultimately contribute to poverty eradication (Mwatela, 2008).

In terms of regulator)- and legal frameworks, the Microfinance Act of 2008 addresses licensing provisions, minimum capital requirements and minimum liquid assets, submission of accounts to the Central Bank of Kenya, supervision by the Central Bank, and limits on loan and credit facilities. It also seeks to protect depositors by requiring that deposit-taking MFIs contribute to the deposit protection fund. Key achievements of the microfinance sector include improved accessibility to financial services by low-income Kenyans although the pace of improvement may not be as satisfactory as the challenges for reaching out to more people remains (CBK, 2008).

1.2 Research Problem

The role of microfinance institutions is crucial in the campaign for financial inclusion since they act as financial intermediaries between the formal sector and low income earners as well as the poor. Moreover, MFIs operate in unique ways that the formal financial sector may find difficult to do. MFIs possess the requisite expertise and experience in dealing with the micro sector of the economy. MFIs function is therefore viewed as essential in the implementation of financial inclusion at the micro level of the economy. However, assessment of theoretical and empirical studies as well as works of practioners both locally and abroad by microfinance theorists showed significant level of divergence on the effectiveness of the microfinance industry.

A World Bank study in 1995 estimated that the formal financial system in most developing countries reaches only the top 25 percent of the economically active population thereby shifting the focus of these countries significantly to microfinance ((Sinha, 2004)). A study conducted by Hans in 2009 described microfinance as a tool for financial inclusion and a lending model that offers reasonable and sustainable rates to the poor taking the place of traders and money lenders who traditionally provided credit to the rural poor at exorbitant prices.

Jayasheela, Dinesha, and Hans (2009) in their overview of financial inclusion and microfinance in India to examine the role of microfinance in the empowerment of people concluded that while there are reservations about the effectiveness of MFIs in handling public money, MFIs growth and achievements demand attention and appreciation. They stated that there was increasing demand for rural finance and inadequacies of formal sources and therefore the need to empower MFIs since they have immense opportunities in the concept of micro credit, micro savings and other financial services provided on micro basis which are fundamental to financial inclusion among the poor.

On the other hand, Bateman (2011) claims that supporters of microfinance have now accepted their failure and resulted to deploying other goals one of which is financial inclusion to justify the high level of attention and funding received in the past by the microfinance industry making specific reference to the famous Grameen Bank of Bangladesh. Bateman Further declared that there was deeper fear among industry members that microfinance might not only be failing to meet its goals of helping poor economies and societies but was instead destroying them. He concluded that the industry was in the state of instability.

Locally, two studies conducted by Malkamaki, Johnson, Zarazua (FSD, 2006 and 2009) to assess the role of informal financial groups of which MFIs are part in extending access in Kenya concluded that there was no reliable data at the national level to support success even though there was fascination about the popularity and apparent success of microfinance. Also in a paper presented by Esipisu of KADET at the Southern Africa Sub Regional Workshop 2005, spoke of challenges and key among them being the absence of specific financial sector policies for microfinance practices which has been addressed by the enactment of the Microfinance Act 2008.

Taking into account the conflicting results on the role of microfinance institutions in the implementation of financial inclusion and the absence of a local study with specific focus on the challenge on the microfinance industry that its participation in financial inclusion is only a ploy designed to cover up for its failure in carrying out its traditional function of poverty alleviation; this study seeks to examine the effectiveness on the role of microfinance institutions relative to the financial inclusion process in Nairobi.

The research question therefore is: How effective are microfinance institutions in carrying out financial inclusion?

1.3 Objective of the Study

To examine the effectiveness of microfinance institutions in implementing financial inclusion in Nairobi

1.4. Value of the Study

MFIs would be able to realize their role either as effective means of implementing financial inclusion and poverty alleviation or a mere goal rotating ploy designed to cover up for their failure and maintain supports to the industry. This realization would serve as a basis for improving policies and regulations that shall enhance the ability of MFIs to improve on their strategies for providing adequate access to financial resources by low-income earners, SMEs and the poor with emphasis on investments, savings, growth and poverty reduction.

The research would also bring in current statistics that the government can utilize in analyzing the micro financial sector with the view of devising policies that will enhance the operations of the sector. The government would be able to know as to whether microfinance is a good economic policy and assisting in the alleviation of poverty or not. The need for accessibility of credit and its sustainability by low-income earners and poor Kenyans would come into the limelight. The study would in addition assist the government in its desire to create and facilitate favorable credit and investment policies for low-income earners, owners of SMEs as well as the poor. While some laws have been enacted to regulate the microfinance industry, the findings of this study may trigger further regulatory actions to enhance the operational efficiency of the industry.

In the development of government policy papers the role of the microfinance sector needs to be highlighted as means of ensuring the effective participation of MFIs in the financial inclusion process. Policy makers would be able to know how well to incorporate the sector and how effective to ensure its full participation in the financial inclusion activities.

The research would also provide valuable information regarding the microfinance sector. Being upcoming entrepreneurs the academicians would be furnished with relevant information regarding credit availability through the microfinance sector. It would contribute to the general body of knowledge and form a basis for further research. Moreover, it may set the basis for developing formal text materials which shall be used to further educate interested individuals in becoming professionals in the sector. The major and traditional role of MFIs is to reach low-income earners, poor and owners of SMEs who cannot meet the criteria for accessing funds from the formal financial sector. Through this research, low-income earners, the poor and owners of SMEs would become aware of the availability of affordable credit, rates, and the criteria for consideration. The study would enlighten them of the need to seek knowledge of the methodology to efficiently and effectively manage borrowed funds, investments and savings that would eventually lead to their lifting from poverty.

Finally, the study would bring to the fore the existing argument as to whether microfinance is a good development model and or a failure.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter discusses the literature review used in the study. Section 2.1 gives outlines of the theoretical framework; Section 2.2 discusses details of the theoretical frameworks of microfinance; section 2.3 details the roles of MFIs in financial inclusion; Section 2.4 discusses the implementation of financial inclusion by MFIs; section 2.5 details the key models of microfinance and discusses empirical studies and section 2.6 discusses the empirical studies of microfinance and section 2.7 concludes and summarizes the empirical studies.

2.2. Theoretical Framework

2.2.1 Social Capital Theory

The concept of social capital existed ever since small communities formed and humans interacted with the expectation of reciprocation and trust. However, the term in its present form and associated meanings was popularized amongst others by Bourdieu, Coleman and Putnam.

There are many possible representations of social capital. Broadly, social capital can be seen in terms of five dimensions: first, networks-lateral associations that vary in density and size, and occur among both individuals and groups; second, reciprocity-expectation that in short or long run, kindness and services will be returned; third, trust-willingness to take initiatives (or risk) in a social context based on assumption that others will respond as expected; fourth, social norms-the unwritten shared values that direct behavior and interaction; and fifth, personal and collective efficacy-the active and willing engagement of citizens within participative community. These five dimensions manifest themselves in various combinations and shape the interaction amongst the members of a group, organization, community, society or simply network and can be studied through various perspectives.

Social capital is a broad term that encompasses the 'norms and networks facilitating collective actions for mutual benefits' (Woolcock, 1998). This broad definition of the term makes it susceptible to multiple interpretations and usage which span multiple theoretical traditions). At one end social capital can be seen as a notion that is based on the premise that social relations have potential to facilitate the accrual of economic or non-economic benefits to the individuals and on the other end social capital can be seen to reside in the relations and not in the individual.

Social capital is context dependent and takes many different interrelated forms, including obligations (within a group), trust, intergenerational closure, norms, and sanctions with underlying assumptions that the relationships between individuals are durable and subjectively felt. An example of social capital could be the voluntary participation of members over a lunch break to discuss various social/organizational aspects which benefits all the participants. Another important aspect of the social capital theory is of economic growth in which economic actors interact and organize themselves to generate growth and development (Nyangena, Sterner, 2008).

In development policy, social capital is viewed as a productive asset which can be strategically mobilized by individuals and groups for particular ends (Wong 2003; World Bank 2001). Social capital is a valuable asset, but like all kinds of capital it can be misused. The ways in which Social capital affects economic growth in broader terms can be summarized as building trust in institutions and people, which facilitates cooperative decision making and action (Nyangena, Sterner, 2008). It is from this perspective that microfinance institutions work and act for the benefit of all members.

2.2.2 Joint-Liability Theory

Early theoretical work on microfinance focused on joint liability, where a small group of borrowers are held jointly liable for one another's repayments, as the key to high loan recovery rates. But while joint liability remains a feature in the majority of microfinance loan contracts, it is no longer the sole focus. Several factors have contributed to this change. A number of large micro-lenders have expanded into or converted their portfolios to individual liability loans, although the evidence on the effects of these changes remains inconclusive.

There has also been a growing recognition of the potential costs of joint liability ((Banerjee, Besley and Guinnane, 1994; Besley and Coati, 1995; Fischer 2009)).

2.2.3 Present-Biased Theory

Fischer and Ghatak (2009) propose an alternative theory based on present-biased, quasi hyperbolic preferences in order to capture the belief of many microfinance practitioners that clients benefit from the fiscal discipline required by a frequent repayment schedule. Their work is motivated by a pervasive sense among practitioners that frequent repayment is critical to achieving high repayment rates. Yunus observed that the model that captures this is stark in order to highlight one particular effect: if borrowers are present-biased, frequent repayment can increase the maximum loan size for which repayment is incentive-compatible. Intuitively, when borrowers are present-biased, the immediate gain to defaulting on any large repayment is subject to significant temptation. When these payments are spread out, the instantaneous repayment burden at any time is smaller and thus less subject to temptation. Frequent repayment also means that at the time of the first payment, the rewards (typically access to future credit) are further away from the repayment decision and thus more heavily discounted.

2.2.4 Frequent Repayment Theory

Frequent repayment imposes an opportunity cost of meeting attendance on borrowers and direct costs on the lender. It might also distort the investment incentives of borrowers toward projects that generate consistent, if meager, returns. The optimal frequency balances these costs against the positive incentive effects. The behavioral factors motivating frequent repayment for loans can also create demand for commitment savings products, ranging from ROSCAs to formal financial products with time or amount targets. For a time, the excitement surrounding micro lending seemed to crowd out interest in savings behavior, but interest has flooded back (Fischer, Ghatak, 2009).

2.3. The Role of MFIs in Financial Inclusion

The role of MFIs in the financial inclusion process is crucial since the focus is mainly on the poor who are often the excluded. In the wake of the intense global concern to lift people out of exclusion, the need for recognition of the pivotal role that MFIs play in reaching out to low-income earners and the poor who make up the bulk of the world's population must be placed on national agenda if the goal of financially including people is to be achieved. According to Rangarajan (2008), access to finance by the poor and vulnerable groups is a prerequisite for poverty reduction and social cohesion. It is an essential part of efforts to promote inclusive growth as providing access to finance is a form of empowerment of vulnerable groups.

He referred to financial inclusion as the delivery of financial services at affordable cost to vast sections of disadvantaged and low-income groups. These services include credits, savings, insurance, payments and remittance facilities. Financial inclusion also has as its objective the extension of the scope of activities of the organized financial system (formal banking system) to embrace within its domain people with low incomes. Accordingly, micro finance institutions (MFIs) can play a significant role in facilitating inclusion since they are uniquely positioned in reaching out to the rural poor.

Many MFIs operate in limited geographical area, have greater understanding of issues specific to the rural poor, enjoy greater acceptability amongst the rural poor and have flexibility in their operations which provides a level of comfort to their customers at the lower income brackets (Rangarajan, 2008). Microfinance is also a powerful tool for achieving higher levels of financial inclusion in developing economies thereby facilitating efficiency and equity benefits. Microfinance also provides opportunities and attracts private capital flows. Regional networks of microfinance service providers can provide useful entry points for action in key economies (Conroy, 2008)

2.4 Successes and Challenges of Microfinance

Fischer and Ghatak (2010) reviewed theoretical and empirical studies of microfinance. The objective was to highlight the main points of divergence between theoretical and empirical studies and their inter connections. The analysis revealed that theories were developed but that there have been no empirical studies done to prove the issues or points contained in the theories. The study also identified issues of conflicting theories for the purpose of harmonizing the conflicting views and resolves debates and offer insights on how future research can bridge the gap(s) between theoretical and empirical works. Another gap is that between academic research and works carried out by practitioners. Practitioners are pioneers whose works will ultimately give researchers basic materials to enable them think about what is likely to work or not whether those works were successes or failures.

The study identified the following as gaps between theoretical, empirical and microfinance practioners. Hulme and Mosley (1996) in a comprehensive study on the use of microfinance to combat poverty, argue that well-designed programmes can improve the incomes of the poor and move them out of poverty. They further state that "there is clear evidence that the impact of a loan on a borrower's income is related to the level of income" as those with higher incomes have a greater range of investment opportunities. They indicated that credit schemes are more likely to benefit the "middle and upper poor". They also revealed that when MFIs such as the Grameen Bank and BRAC provided credit to very poor households they were able to raise their incomes and their assets. Mayoux (2001) further states that while microfinance has much potential, the main effects on poverty have been the significant contribution credit has made by increasing incomes of the better-off poor including women.

Hulme and Mosley (1996) show that when loans associated with increase in assets, borrowers are encouraged to invest in low-risk income generating activities and the very poor are encouraged to save; vulnerability of the very poor is reduced and their poverty situation improves as well. Johnson and Rogaly (1997) also refer to examples of savings and credit schemes that were able to meet the needs of the very poor. They state that microfinance specialists are beginning to view improvements in economic security, rather than income promotion, as the first step in poverty reduction as this reduces beneficiaries' overall vulnerability.

However, from the examination of the role of MFIs in development, specifically in relation to alleviating poverty, there remain some levels of misunderstandings. The key challenge facing MFIs today that are affecting their impact on poverty alleviation were seen to be an over-emphasis on financial sustainability over social objectives, and a failure of many MFIs to work with the poorest in society (Morduch, 2004). The impact of microfinance on poverty alleviation has been keenly debated and remains an unresolved issue. It is generally accepted that it is not a silver bullet and has not lived up, in general, to expectation (Hulme and Mosley, 1996)

Despite the apparent success and popularity of microfinance, no clear evidence yet exists that microfinance programmes have positive impacts (Armendariz de Aghion and Morduch 2005, 2010) on its targets especially the poor. Four major reviews were conducted to examine the impacts of microfinance on financial inclusion and poverty reduction ((Sebstad, Chen (1996); Gaile and Foster 1996, Goldberg 2005, Odell 2010, Orso 2011)). The reviews concluded that, in the midst of the anecdotes and other inspiring stories ((Todd. 1996)) purported to show that microfinance can make a real difference in the lives of those served, rigorous quantitative evidence on the nature, magnitude and balance of microfinance impact is still scarce and inconclusive ((Armendariz de Aghion and Morduch 2005, 2010)).

Overall, it is widely acknowledged that no well-known study robustly shows any strong impacts of microfinance (Armendariz de Aghion and Morduch 2005). Because of the growth of the microfinance industry and the attention the sector has received from policy makers, donors and private investors in recent years, existing microfinance impact evaluations need to be re-investigated; the robustness of claims that microfinance successfully alleviates poverty and empowers women must be scrutinised more carefully.

Bateman (2011) also in his study of microfinance claims that supporters of microfinance now accept their failure and have therefore resulted to sedulously deploy other goals with satisfaction. They want to use the achievement of these goals to justify the high level of attention and funding received in the past by the famous Grameen Bank of Bangladesh and the microfinance in general. And chief among them is financial inclusion which is the provision of bank accounts for the poor. This criticism seems to be an unending bad news for microfinance. He also asserts that there is now deeper fear among practioners that microfinance might be failing to meet its goals of helping poor economies and societies. Instead of helping them, it is instead destroying them. The critics claim that in the face of the criticism, the microfinance industry has now embark on a form of goal rotation as means of getting more supports to the industry. Bateman further stated that some analysts out of desperation do claim that jobs created within the MFIs are some of the positive achievement of microfinance. He concluded that microfinance is in the state of confusion.

This argument has heightens the ante whether microfinance is a good development policy or not and that evidences are accumulating in the most saturated countries, regions and localities like India, Bangladesh and Mexico that the poor are now trapped in poverty. This is not because of the ubiquity of microfinance but microfinance itself (Bateman, 2011).

He concluded that microfinance is a mixed blessing acknowledging that some analysts point out some of the benefits for the poor such as the escape from poverty with a loan that lead to a successful micro enterprise and that the poor also value microfinance as a source of loan offered at lower interest rates than the traditional money lenders. He also admitted that these benefits are not dismissed lightly but that they do not represent the whole picture of microfinance activities raising the question as to whether the benefit outweighs the cost.

Locally, FinAccess (2009) claims that Kenya has made impressive strides over the past 5 years in financial inclusion indicating that while formal exclusion has yet to match levels in Southern Africa, the proportion of the population that is completely excluded in Kenya is lower than any other African country with South Africa being an exception naming MFIs as being among drivers of financial inclusion in Kenya. FinAccess further revealed that MFIs, even though still a small actor in the Kenyan financial sector, were able to doubled their outreach from 1.7% in 2006 to 3.4% in 2009.

2.5. **Financial Inclusion** by **MFIs in Kenya**

According to the FSD-Kenya (2009) roughly four out of every five Kenyans live in rural areas and many of them rely directly or indirectly on agriculture for their livelihoods. Of this rural population, 35.9% has no access to any form of financial service. Thus, rural finance remains a priority for Financial Sector Deepening in its endeavor to build inclusive financial markets. Many Kenyans experience constraints in accessing finance. FSD Kenya's mission is to support the development of inclusive financial markets as a means to stimulate wealth creation and reduce poverty in Kenya.

Accordingly, in 2006, Fin Access conducted a survey and came up with a number of statistics and estimated that the formal financial system was serving just over a quarter meaning 26.4 percent of Kenya's adult population. Among other actors in the financial sector offering various percentages of financial services to the population, microfinance institutions were rated the least significant with only 1.7 percent using them. In terms of contribution to access, banks (including the Post bank) contributed to 18.5 percentage points (70 percent of the access), while the non-bank institutions (SACCOs and MFIs) add 7.8 percentage points (30 percent of the access).

FSD (2009) indicated that Kenya made impressive strides over a 5 years period (2006-2010) in financial inclusion. And while formal exclusion has yet to match levels in Southern Africa, the proportion of the population which is completely excluded is lower in Kenya than any other African country except for South Africa.

However, FSD's statistics also reported some key factors posing as challenges to the financial inclusion efforts and was seeking to address them. The dominance of agriculture in rural economies, large distances between consumers and market centers, lower incomes and poor financial literacy were listed as some of the factors which constrain access. FSD also stressed a note of importance that many of its projects in other theme areas impact on rural finance but were not exclusively focused on rural access and indicated that projects such as support to KWFT, Faulu, Kenya Post Office Savings Bank (KPOSB), and SACCO also make a significant contribution to rural finance with over 50% of their activities being rural. Physical access was also listed as one of the major hurdles to improving the usage of formal services in the rural areas. While the expansion in branches and ATM channels by commercial banks is increasing the reach of the financial system into rural areas, many potential users remain far from an access point. To expand beyond this point, some micro-finance institutions (MFIs) have also been reaching deeper into the rural areas using low cost field offices,. Nevertheless overall outreach from MFIs remains relatively modest and the services provided limited to credit products (FSD, 2009).

Microfinance which is the provisions of financial services to the poor, low-income households and micro and small enterprises (MSEs), provide an enormous potential to support the economic activities of the poor and thus contribute to poverty alleviation. Widespread experiences and research have shown the importance of savings and credit facilities for the poor and MSEs. This puts emphasis on the sound development of microfinance institutions as vital ingredients for investment, employment, economic growth and poverty reduction in particular (PRSP, 1999).

The potential of using institutional credit and other financial services for poverty alleviation in Kenya is quite significant. About 18 million people, or 60% of the population, are poor and mostly out of the scope of formal banking services. According to the National Micro and Small Enterprise Baseline Survey of 1999, there are close to 1.3 million MSEs employing nearly 2.3 million people or 20% of the country's total employment and contributing 18% of overall GDP and 25% of non-agricultural GDP (PRSP, 1999).

Despite this important contribution, only 10.4% of the MSEs receive credit and other financial services. The formal banking sector in Kenya over the years has regarded the informal sector as risky and not commercial microfinance, the provisions of financial services to the low-income households and micro and small enterprises (MSEs), provide an enormous potential to support the economic activities of the poor and thus contribute to poverty alleviation. Widespread experiences and research have shown the importance of savings and credit facilities for the poor and MSEs. This puts emphasis on the sound development of microfinance institutions as vital ingredients for investment, employment and economic growth (PRSP, 1999).

According to the National Micro and Small Enterprise Baseline Survey of 1999, there are close to 1.3 million MSEs employing nearly 2.3 million people or 20% of the country's total employment and contributing 18% of overall GDP and 25% of non-agricultural GDP. Despite this important contribution, only 10.4% of the MSEs receive credit and other financial services. This statistics could be used to give a vivid picture of the microfinance industry in Kenya and the importance of the effectiveness of role of MFIs for poverty alleviation (PRSP, 1999).

The formal banking sector in Kenya over the years has regarded the informal sector as risky and not commercially viable. According to the Poverty Reduction Strategy Paper (PRSP) of 1999, a large number of Kenyans derive their livelihood from the MSEs that also have their origin in microfinance. Therefore, development of this sector represents an important means of creating employment, promoting growth, and reducing poverty in the long-term. However, in spite of the importance of this sector, experience shows that provision and delivery of credit and other financial services to the sector by formal financial institutions, such as commercial banks has been below expectation. This means that it is difficult for the poor to climb out of poverty due to lack of finance for their productive activities. Hence, new innovative and pro-poor modes of financing low-income households and MSEs based on sound operating principles need to be developed (PRSP, 1999).

In the past, microfinance institutions (MFIs) established using either an NGO or a savings and credit co-operative societies framework have been important sources of credit for a large number of low income households and MSEs in the rural and urban areas of Kenya. The MFIs have, however, operated without an appropriate policy and legal framework. There is therefore need to focus more on these institutions to enhance their effectiveness in the provision of savings, credit and other financial services to the poor and MSEs (PRSP, 1999).

The Government of Kenya recognizes that greater access to, and sustainable flow of financial services, particularly credit, to the low-income households and MSEs is critical to poverty alleviation. Therefore, an appropriate policy, legal and regulatory framework to promote a viable and sustainable system of microfinance in the country has been developed via the proposed Deposit Taking Microfinance Bill. In drafting the Bill, the Government consulted with stakeholders to get their views on the best way to create the required enabling environment for the microfinance sub-sector. In addition, full-fledged microfinance units have been established in the Ministry of Finance (the Treasury) and the Central Bank of Kenya to formulate policies and procedures to address the challenges facing microfinance institutions, especially in the rural areas, and to build a database to facilitate better regulation and monitoring of their operations (PRSP, 1999).

2.6 Key Models of Microfinance

According to Fehmeen (2010), association is formed by the poor in the target community to offer microfinance services such as micro savings, micro credits, micro-insurance, etc. to them. The association, which can be formed on the basis of gender, religion or political and cultural orientation of its members, then gathers capital and intermediates between banks, MFIs and its members. Some examples include Self Help Groups (SHGs) that are prevalent in India. According to FSD Kenya (2009) associations are usually referred to as the informal groups and are classified under five types: Welfare/clan group (WCG); ROSCAs; Individual ASCAs; managed ASCAs; and investment clubs. Welfare/Clan Groups do not intermediate funds but provide financial support for members and their next of kin in the case of illness, death etc. Rotating Savings and Credit Associations (ROSCAs) and Accumulating Savings and Credit Associations (ASCAs) facilitate saving and lending within groups.

2.6.1 Rotating Savings and Credit Associations (ROSCAs)

In a ROSCA group meeting savings are collected, the whole pot is then immediately given to one member who has not yet received the pot (Fehmeen, 2010).

2.6.2 Accumulating Savings and Credit Associations (ASCAs)

In the case of ASCAs, funds are lent to willing borrowers with interest. The interest paid on the loans will then accumulate in the group fund. Investment clubs are more recent phenomena. People come together to form a group in order to invest in property or business (Fehmeen, 2010).

2.6.3 Banks/Village Banks

Community Banks/Village Banks are formal versions of 'associations' and are created by members of a target community who wish to improve their living standards and to generate employment. By offering microfinance services, these banks seek to develop their communities. Guarantees are provided by social collateral (peer-pressure) as services are distributed through 5-member groups where each member's eligibility for loans is based on his/her peer's performance. The Grameen Bank of Bangladesh and the MuCoBa of Tanzania are examples (Fehmeen, 2010).

2.6.4 Cooperatives

Cooperatives are like the associations and Community models except that their ownership structure does not include the poor. A group of middle or upper class individuals like the Co-operative Banks of Kenya, Bank of England and Cooperative Rural Bank of Bulacan in Philippines may form a cooperative to offer microfinance services to the poor. In this case the target is the poor but the lending model is formed by middle or upper class (Fehmeen, 2010).

2.6.5 Credit Union

A credit union is a model in which members of a target community gather their money and make loans to one another at low and affordable interest rates. When compared to the community banks, credit unions are much smaller and are non-profit oriented, charging interest rates that merely allow sustainability (Fehmeen, 2010).

2.6.6 Non-Governmental Organizations (NGOs)

Unlike community-based models, Non-Governmental Organizations NGOs are external organizations and their activities range from offering microfinance services (loans, insurance, savings, etc.) to improving credit rating of the poor, training, education and research. NGOs may also act as intermediaries between the poor and donor agencies such as UN, ADB, World Bank and operate locally, as well as globally (Fehmeen, 2010).

2.7 Empirical Studies

Through the creativity of empirical researchers and the willingness of microfinance practitioners to experiment and innovate, there has been some level of development for special design of facts that move beyond theoretical foundations. The issue is how to bridge the gap between theoretical and empirical research in microfinance. The argument is that theoretical and empirical researches in the area of microfinance remain largely disjointed thus shifting the understanding of researchers to a level where the next great steps require unifying these two strands (theoretical and empirical studies) with input of practitioners. What is true throughout economics is emphasized by the pace of innovation in microfinance thereby stressing the need to utilize theory to make sense of the experimental evidence and generalize results beyond their immediate context (Fischer, 2010).

In turn, there is the need to subject microfinance theories to empirical testing and refine them where warranted. This is essential to the current believe and should be the next step in the research agenda whereby existing or new theory shall be explicitly used to design future experiments and as the ex ante framework for more empirical work. A more effective dialogue between theoretical and field researchers can do more than just extend the frontier of acadcmic knowledge. It can also facilitate translating research into action. Theories that are not tested may give some insights but are unlikely to be considered by microfinance institutions and donors, let alone influence their operations. Similarly, field experiments conducted without sound theoretical foundations have little to say about the underlying mechanisms through which a policy or program operates. Without such foundations, experiments can be limited to providing information about only a particular policy in a particular location, and out-of-sample predictions can be little more than guesswork. Unifying theory and field experiment can help practitioners make sense of and utilize academic results to contribute to poverty reduction and other institutional aims (Fischer, 2010).

Microfinance interventions have also been shown to have a positive impact on the education of clients' children. Littlefield, Murduch and Hashemi ((2003)), state that one of the first things that poor people do with new income from microenterprise activities is to invest in their children's education. Studies show that children of microfinance clients are more likely to go to school and stay longer in school than for children of non-clients. Again, in their study of FOCCAS, client households were found to be investing more in education than non-ciient households.

Similar findings were seen for projects in Zimbabwe, India, Honduras and Bangladesh. Robinson ((2001)) in a study of 16 different MFIs from all over the world shows that having access to microfinance services has led to an enhancement in the quality of life of clients, an increase in their self-confidence, and has helped them to diversify their livelihood security strategies and thereby increase income among the poor.

Chowdhury and Bhuiya ((2004)) assessed impact of BRAC's poverty alleviation programme from a "human well-being" perspective in a programme in Bangladesh where they examined seven dimensions of 'human-well being. The project included the provision of microfinance and training of clients on human and legal rights. They noted that the project led to better child survival rates, higher nutritional status, improvement in the basic level of education, and increased networking in the community. Various studies and findings indicate that microfinance can, and is having very positive and diverse impacts at a beneficiary level.

Imp-Act ((2004)) gives examples where the impact of microfinance projects goes beyond clients. They refer to studies on CERUDEB, an MFI in Uganda, which show that loans given to small farmers have resulted in substantial increases in part-time and permanent wage labour of non-clients. Even though the clients themselves were usually above the poverty line, the people they employed were not, thereby showing the positive knock-on effects of such an intervention, even if the poorest were not targeted. Mosley and Rock ((2004)) in a study of six African MFIs found similar results. They concluded from their study that MFI services provided to them can reduce poverty by sucking very poor people into the labour market as employees of microfinance clients. They also state that microfinance services often enhance human capital through increased spending on education and health that may extend to poor households through intra household and inter-generational effects.

Zohir and Matin ((2004)) state that many MFI loans are used for agricultural production, trading, processing and transport, resulting in an increase in the use of agricultural inputs and increased output of agricultural production. This leads to enhanced employment opportunities in these sectors for the wider community and a reduction in the prices of such produce due to increased supply. They also state that trading activities financed by MFIs can help to establish new marketing links and increase the income of traders.

According to Wrenn (2005), in spite of evidence of microfinance providing access to financial resources and alleviating poverty, debates are also taking place in the field which criticizes the mode of implementing the functions of MFIs and their impact on the poor who are the prime target for microfinance practice. One aspect of the debates is on impact measurement. On account of this, there are two major issues that required further study: reaching the poor and financial sustainability. Reaching the poor is one of the key roles microfinance has to play in developing and bringing access to financial services for the poor as well as to those who are neglected by the formal banking sector. This is their social mission.

Therefore, if MFIs are to fill this void they must reach the rural poor. However, according to most studies, microfinance is only reaching a small fraction of the estimated demand of the poor for financial services (Littlefield and Rosenberg, 2004). Moreover, MFIs do not have the depth of outreach that is needed to meet the demands of the rural poor. Serving the rural poor in the developing world involves a major financial commitment, as it is expensive to run rural microfinance projects. Claessens (2005) states that high transaction costs, small volumes and the high costs of expanding outreach, make it unprofitable to serve the rural poor; giving it as reason for which commercial banks are positioned in areas of high population density.
Another common criticism according to Wrenn (2005) of the current operational procedures of MFIs, for instance, peer group self selection and the drive for self-sustainability, is that

they end up working with the moderately poor, and marginalising the poorest of the poor. Simanowitz (2001) highlights a number of factors leading to the marginalisation of the poorest, which lessens the impact microfinance is having on poverty; self exclusion, exclusion by other members, exclusion by MFI staff and exclusion by design. Markowski **(2002)** and Rogaly (1996) argue that MFIs in their project designs are failing to meet the needs of the very poor and destitute, who do have a demand for microfinance services, especially for savings (Littlefield and Rosenberg, 2004 and Dichter, 1999).

2.8 Summary and Conclusion

This study is intended to examine the role of microfinance institutions in financial inclusion in Nairobi. Several studies have reported that microfinance is a tool for the alleviation of poverty among the poor, a development model and that specific components like savings and credit schemes are able to meet the needs of the very poor and those excluded from financial services. Studies in leading practicing countries like India, Bangladesh and Mexico considered as saturated areas for microfinance have branded the model as means of poverty alleviation, women empowerment. These studies have credited microfinance to linking the poor to the formal financial sector and effectively delivering services to cities, densely populated urban and rural areas. Local studies and presentation by Ogama (2006), FinAccess/FSD-Kenya (2009) Mwatela (2008) also give success stories with only minor operational challenges of MFIs in Kenya.

However, similar studies have reported negative relationship between microfinance and the provision of financial access to the poor claiming that there remain some levels of misunderstandings regarding the role of MFIs in development, specifically in relation to alleviating poverty. It is further argued that despite the apparent success stories and popularity of microfinance, no clear evidence yet exists that microfinance programmes have positive impacts on its targets especially the poor citing major reviews done to assess the impacts of microfinance on financial inclusion and poverty reduction ((Armendariz de Aghion and Morduch 2005,2010; and many others).

Opponents of microfinance suggest that microfinance practioners have now "accepted" their failure and have resulted to goals rotation with financial inclusion as the key object. The critics believe that MFIs are now trying to use these new goals to justify the high level of attention and funding received by the microfinance industry in the past in order to maintain the outflow of support to the industry.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

In this chapter, the research methodology used in the study is described. The study design and the population are described. The instrument used to collect the data including methods applied to maintain validity and reliability of the instrument are also described.

3.2 Research Design

The study adopted the descriptive research method to examine the role of MFIs in the implementation of financial inclusion in Nairobi. A descriptive survey design was used to collect original data for describing the population. The survey obtained information from people through self-report. By this, people respond to questions posed through questionnaires by an investigator (Polit and Hungler, 1993). Both quantitative and qualitative approaches to data analysis were employed, ft is worth noting that closed questions were analysed using quantitative analysis and open-ended questions were analysed using qualitative analysis.

3.3 Population

Burns and Grove (1993) defines population as all elements (individuals, objects and events) that meet the criteria for inclusion in a study. Sekarans (1997) also defined population as the entire group of people, events or things of interest that the researcher wishes to examine. The target population comprised all MFI's in Nairobi that are registered with the Association of Microfinance Institutions of Kenya (AMFI-K). Since the number of MFIs was less, the entire population of registered MFIs was included in the survey. As at 2011, there were 53 registered members Kenya. However, the focus of the research was on the 47 MFIs located in Nairobi.

3.4 Data Collection

Primary data was collected using questionnaires. The questionnaires contained two parts. Part A and part B; both parts had open-ended and closed-ended questions. Questionnaire is a printed self-report form designed to obtain information that can be obtained through written responses of subjects.

3.4 Data **Reliability and Validity**

Polit and Hungler (1993) refer to reliability as the degree of consistency with which an instrument measures the attribute it is designed to measure. The consistency from responses in the questionnaires determined the level of reliability of the data.

Validity of an instrument is the degree to which an instrument measures what it is intended to measure (Polit and Hungler, 1993). Variety of questions was included on the questionnaires to achieve validity.

3.5 **Data Analysis**

Data collected was edited for accuracy, uniformity, consistency, completeness and arranged to enable coding and tabulation before final analysis. The data was then entered into a computer program called Statistical Package for Social Sciences (SPSS Version 16) for analysis and interpretation Descriptive analysis was used to analyze the data received from MFIs. This involved descriptive tools such as percentages and frequency distributions. The analysis was focused on target clients of MFIs, comparison of types of financial services offered, sources of funding available to MFIs, product designs; especially credit services and savings in order to determine the overall capability of MFIs in reaching out in meeting the financial needs of the population of Nairobi. The findings were summarized to determine the extent to which financial inclusion strategies had been adopted by MFIs.

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND DISCUSSION OF FINDINGS

4.1 Introduction

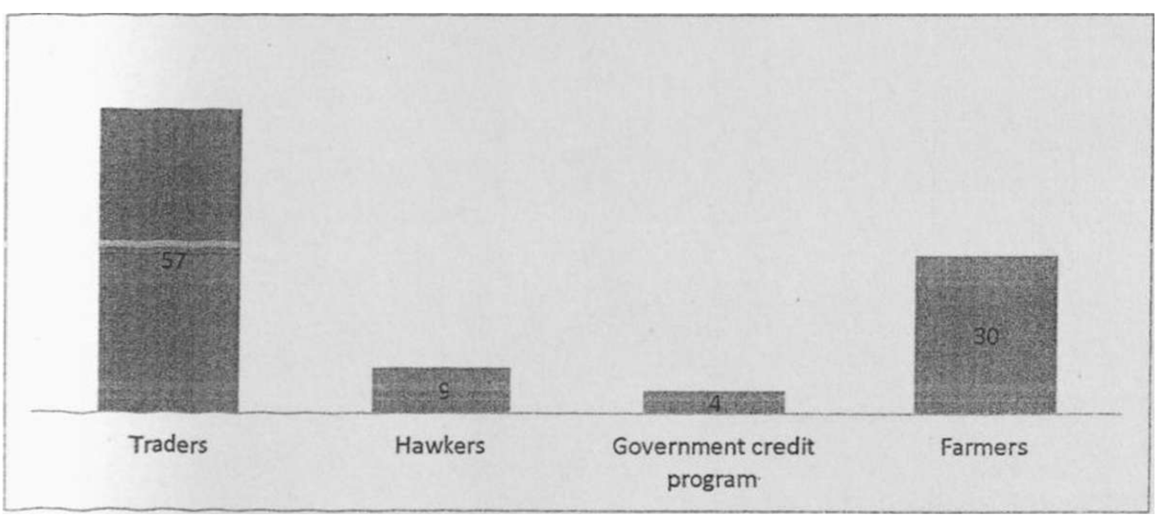
The main objective of the study was to investigate the effectiveness of microfinance institutions in implementing financial inclusion in Nairobi. The study was therefore conducted on microfinance institutions in Nairobi. Qualitative data was analyzed through quantitative analysis while graphs, pie charts and tables were used to present the data. The questionnaires were dropped and picked at a later date to allow the respondents to fill-in the questionnaires at their own time. Once the respondents answered the questionnaires, data was then coded and analyzed using the SPSS.

4.2 Response Rate

The study targeted 47 respondents in collecting data with regard to the effectiveness of microfinance institutions in implementing financial inclusion. From the study, 41 respondents out of the 47 sample respondents filled-in and returned the questionnaires making a response rate of 87%. This reasonable response rate was achieved after the researcher made physical visits to remind the respondents to fill-in and return the questionnaires.

4.3 Operational Design of MFIs

Figure 4. 1: Target client of the MFIs



Source: Research findings

The study sought to find out the target clients of the MFIs. According to the findings, 57% of the MFIs targeted traders, 30% targeted fanners, 9% targeted hawkers and 4% targeted government credit programs.

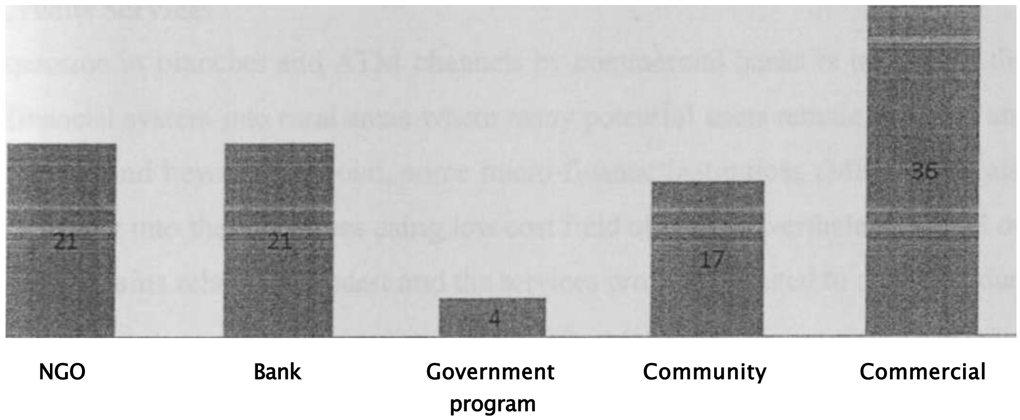
Table 4.1: Financial services offered by the MFIs

Financial Services	Frequency	Percentage (%)
Savings	2	5
Credit	9	22
Savings and credit services	26	63
Cheques clearance	2	5
Money transfer	1	2.4
Standing Order	1	2.4
Total	41	100

Source: Research findings

Regarding financial services offered by the MFIs, 63% offered savings and credit services, 22% offered credit services, 5% offered savings services, 5% offered cheques clearance services, 2.4% offered money transfer services and 2.4% offered standing order services.

Figure **4. 2: Nature (setup) of MFI**



Source: Research findings

The MFIs had different natures. From the findings, 36% of the MFIs were commercial, 21% were NGOs, 21% were banks, 17% were community and 4% were government programs.

Table 4. 2: Main sources for funding

Sources	Frequency	Percentage (%)
Members savings	26	63
Donor funds	9	22
Internally generated revenue	6	15
Total	41	100

Source: Research findings

There are different sources for funding MFIs. Three sources were identified by the research. Respondents indicated that 63% of the MFIs got their funds from members' savings, 22% of the MFIs got their funds from donor funds and 15% of the MFIs got their funds from internally generated revenue.

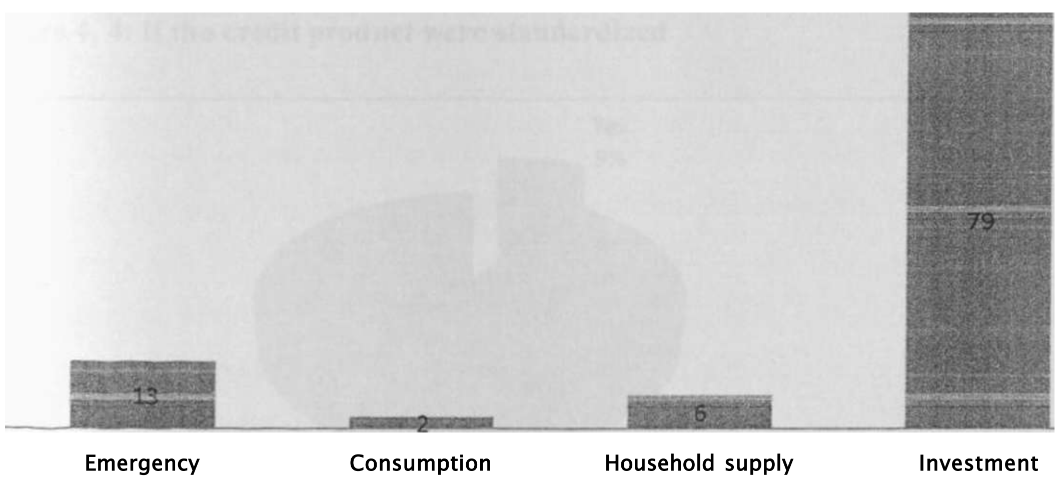
4.4 Product Design

Vision 2030 identifies the need to increase access to affordable financial services and products for a wider section of Kenyans, particularly the poor, low-income households and small- and medium- scale enterprises (SMEs) (Financial Inclusion Kenya, 2009).

4.4.1 Credits Serv ices

The expansion in branches and ATM channels by commercial banks is increasing the reach of the financial system into rural areas where many potential users remain far from an access point. To expand beyond this point, some micro-finance institutions (MFIs) have also been reaching deeper into the rural areas using low cost field offices. Nevertheless overall outreach from MFIs remains relatively modest and the services provided limited to credit products.

Figure 4. 3: Credit Products Provided



Source: Research findings

The study sought to find out credit products provided by MFIs. According to the findings, 79% of the MFIs provided credit product for investment, 13% provided credit product for emergency, 6% provided credit product for household supply and 2% provided credit product for consumption. Rangarajan (2008) referred to financial inclusion as the delivery of financial services at affordable cost to vast sections of disadvantaged and low-income groups. These services include credits, savings, insurance, payments and remittance facilities.

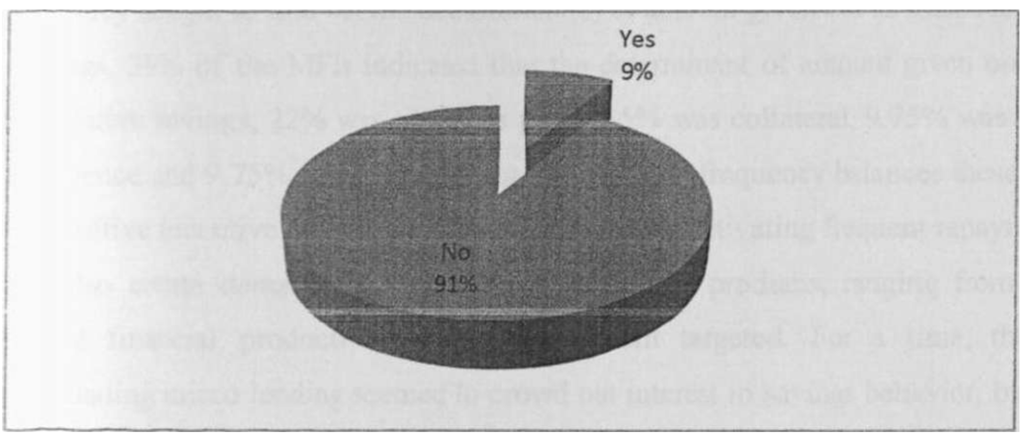
Table 4. 3: If the credit product was tailored

	Frequency	Percentage (%)
Yes	37	91
No	4	9
Total	41	100

Source: Research findings

It was important for the study to investigate if credit products were tailored. From the findings, 91% of the MFIs confirmed that their credit products were tailored while 9% confirmed that their credit products were not tailored. Rangarajan (2008) state the objective of financial inclusion as the comprehensive inclusion that provides a holistic set of services encompassing access to financial services, timely and adequate credit where needed by vulnerable groups such as weaker sections and low income groups at an affordable cost.

Figure 4. 4: If the credit product were standardized



Source: Research findings

It was also important for the study to investigate if credit products were standardized. From the findings, 91% of the MFIs confirmed that their credit products were not standardized while 9% confirmed that their credit products were standardized. A wide range of financial services are provided by the microfinance institutions; ranging from savings and credit facilities, money transfer and micro insurance to the economically poor, low income households and owners of small micro scale enterprises in both rural and urban areas, using innovative delivery methodologies and channels. They ultimately contribute to poverty eradication (Mwatela, 2008).

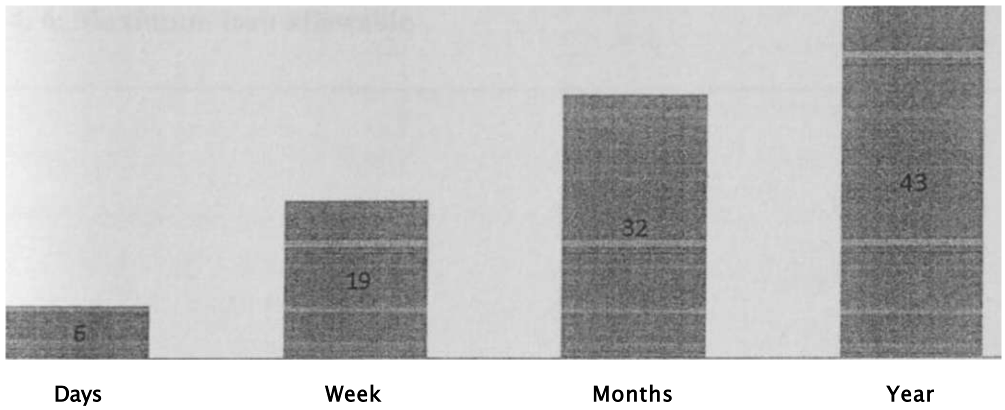
Table 4. 4: Determinant of amount given out as loan

Determinant	Frequency	Percentage (%)
Collateral	8	19.5
Ability to pay	9	22
Previous loan experience	4	9.75
Guaranteeing	4	9.75
Cumulative savings	16	39
Total	41	100

Source: **Research findings**

The study sought to find out the determinant(s) of amount given out as loan. According to the findings, 39% of the MFIs indicated that the determinant of amount given out as loan was cumulative savings, 22% was ability to pay, 19.5% was collateral, 9.75% was previous loan experience and 9.75% was guaranteeing. The optimal frequency balances these costs against the positive incentive effects. The behavioral factors motivating frequent repayment for loans can also create demand for commitment to savings products, ranging from ROSCAs to formal financial products with time or amount targeted. For a time, the excitement surrounding micro lending seemed to crowd out interest in savings behavior, but interest has flooded back (Fischer and Ghatak, 2009).

Figure 4. 5: Duration of borrowing (Loan period)



Source: Research findings

The study sought to find out the duration of borrowing (Loan period). From the findings, 43% of the respondents indicated that the duration of borrowing at the MFIs was a year, 32% months, 19% weeks and 6% indicated the duration of borrowing was days. A number of large micro-lenders have expanded into or converted their portfolios to individual liability loans, although the evidence on the effects of these changes remains inconclusive. There has also been a growing recognition of the potential costs of joint liability ((Banerjee, Besley and Guinnane, 1994; Besley and Coati, 1995; Fischer 2009)).

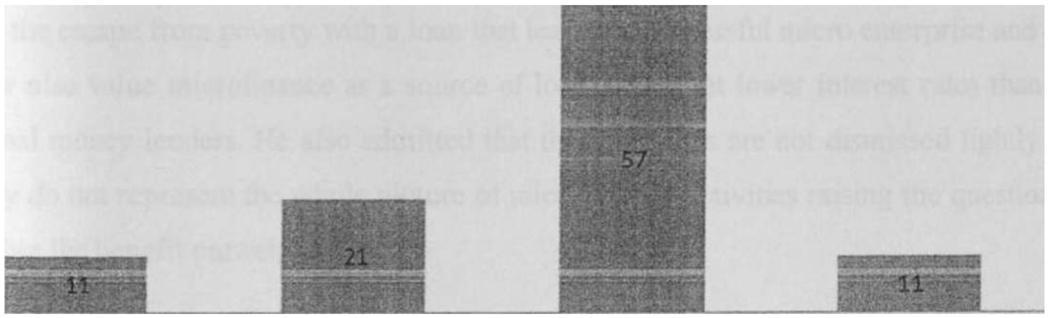
Table 4. 5: Minimum loan allowable

Amount (Kes)	Frequency	Percentage (%)
5,000	19	46
10,000	17	42
50,000	5	12
Total	41	100

Source: Research findings

The study sought to find out the minimum loan allowable. From the findings, 46% of the respondents indicated that the minimum loan allowable was 5,000, 42% of the respondents indicated that the minimum loan allowable was 10,000 and 12% of the respondents indicated that the minimum loan allowable was 50,000.

Figure **4. 6: Maximum loan allowable**



250,000 **500,000** **1,000,000** **5,000,000**

Source: **Research findings**

The study sought to find out the maximum loan allowable. From the findings, 57% of the respondents indicated that the maximum loan allowable was 1,000,000, 21% indicated 500,000, 11% indicated 5,000,000 while 11% of the respondents indicated that the maximum loan allowable was 250,000 respectively. Yunus observed that the model that captures trend is stark in order to highlight one particular effect: that is, if borrowers are present-biased, frequent repayment can increase the maximum loan size for which repayment is incentive-compatible.

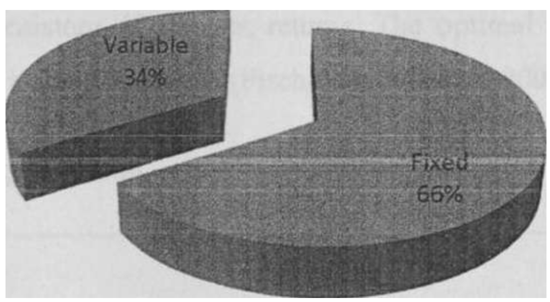
Table **4. 6: Interest rate (Kes) annualized**

	Frequency	Percentage (%)
12%	7	17
15%	17	42
24%	13	31
32%	4	10
Total	41	100

Source: Research findings

The study sought to find out the interest rate (Kes) annualized. According to the findings, 42% of the respondents stated that the interest rate (Kes) annualized was 15%, 31% of the respondents stated that the interest rate (Kes) annualized was 24%, 17% of the respondents stated that the interest rate (Kes) annualized was 12% and 10% of the respondents stated that the interest rate (Kes) annualized was 32%. Bateman (2011) concluded that microfinance is a mixed blessing acknowledging that some analysts point out some of the benefits for the poor such as the escape from poverty with a loan that lead to a successful micro enterprise and that the poor also value microfinance as a source of loan offered at lower interest rates than the traditional money lenders. He also admitted that these benefits are not dismissed lightly but that they do not represent the whole picture of microfinance activities raising the question as to whether the benefit outweighs the cost.

Figure 4. 7: Kind of interest rate



Source: Research findings

The type of interest rate offered by MFIs was also deemed important for the study. According to the findings, 66% of respondents stated that their MFIs used fixed interest rate while 34% of the respondents stated that their MFIs used variable interest rate. Credit unions, when compared to the community banks, credit unions are much smaller and are non-profit oriented, charging interest rates that merely allow sustainability (Fehmeen, 2010).

Table 4. 7: Mode of interest calculation

	Frequency	Percentage (%)
Flat	6	15
Reducing balance	35	85
Total	41	100

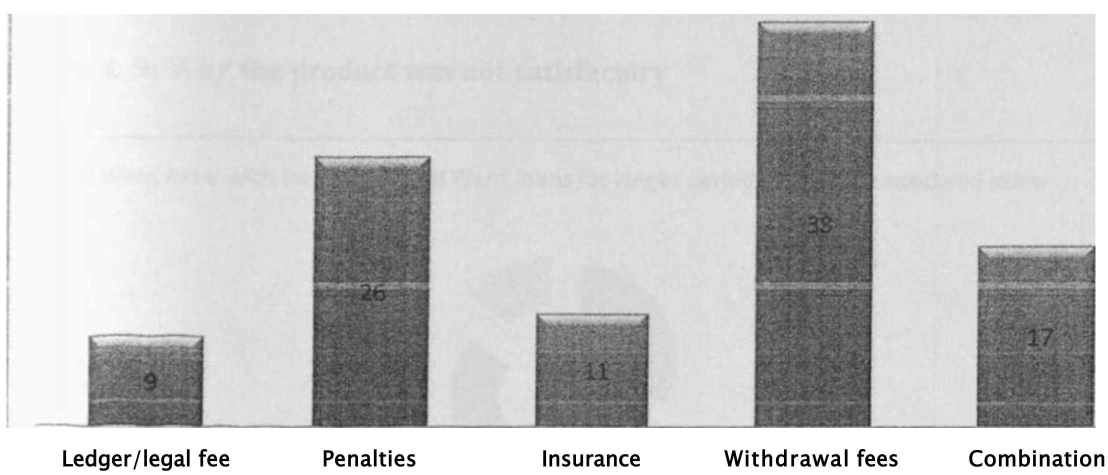
Source: Research findings

The interest calculation varied from one MFI to the other. **85%** of the MFIs calculated interest using reducing balance interest calculation and **15%** of the MFIs calculated interest using flat interest calculation.

4.4.1.1 Repayment scheme

Frequent repayment imposes an opportunity cost of meeting attendance on borrowers and direct costs on the lender. It might also distort the investment incentives of borrowers toward projects that generate consistent, if meager, returns. The optimal frequency balances these costs against the positive incentive effects. (Fischer and Ghatak, 2009).

Figure 4. 8: Other charges on loan



Source: Research findings

The study sought to find out other charges on loans. According to the findings, 38% of the respondents stated that other charges on loan were withdrawal fees, 26% of the respondents stated that other charges on loan were penalties, 17% of the respondents stated that other charges on loan were combination, 11% of the respondents stated that other charges on loan were insurance and 9% of the respondents stated that other charges on loan was ledger/legal fees. Their work is motivated by a pervasive sense among practitioners that frequent repayment is critical to achieving high repayment rates Fischer and Ghatak (2009).

Table 4. 8: If the products met customer's expectation

	Frequency	Percentage (%)
1 Yes	35	85
No	6	15
Total	41	100

Source: Research findings

The study sought to find out if the products met customer's expectation. From the findings, 85% of the respondents stated that the products met customer's expectation while 15% of the respondents stated that the products did not meet customer's expectation. Many MFIs operate in limited geographical area, have greater understanding of issues specific to the rural poor, enjoy greater acceptability amongst the rural poor and have flexibility in their operations which provides a level of comfort to their customers at the lower income brackets (Rangarajan, 2008).

Figure 4. 9: Why the product was not satisfactory

Source: Research findings

The study sought to find out why the product was not satisfactory. According to the findings, 53% of the respondents stated that the product was not satisfactory on the basis that they wanted loans for a longer period, 32% of the respondents stated that the product was not satisfactory on the basis that they wanted more with less security while 15% of the respondents stated that the product was not satisfactory since they wanted unsecured loans. Key achievements of the microfinance sector include improved accessibility to financial services by low-income Kenyans although the pace of improvement may not be as satisfactory as the challenges for reaching out to more people remains (CBK, 2008).

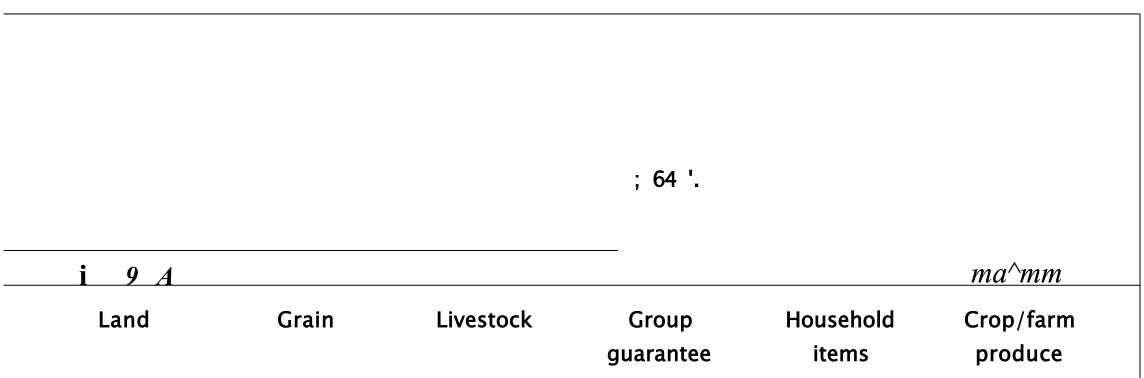
Table 4. 9: If the MFIs required collateral to provide loans

	Frequency	Percentage (%)
Yes	9	21
No	32	79
Total	41	100

Source: Research findings

The study sought to find out if the MFIs required collateral to provide loans. According to the findings, 79% of the respondents stated that MFIs did not require collateral to provide loans while 21% of the respondents stated that MFIs required collateral to provide loans. They state that microfinance specialists are beginning to view improvements in economic security, rather than income promotion, as the first step in poverty reduction as this reduces beneficiaries' overall vulnerability (Ref)-

Figure 4. 10: Type of collateral the MFI accepted from potential clients



Source: Research findings

The study sought to find out types of collateral the MFIs accepted from potential clients. According to the findings, 64% of the respondents stated that the MFIs accepted group guarantee as collateral, 11% accepted livestock as collateral, 9% accepted household items and land as collateral and 4% accepted grain and crop/farm produce as collateral. Guarantees are provided by social collateral (peer-pressure) as services are distributed through 5-member groups where each member's eligibility for loans is based on his/her peer's performance. The Grameen Bank of Bangladesh and the MuCoBa of Tanzania are examples (Fehmeen, 2010).

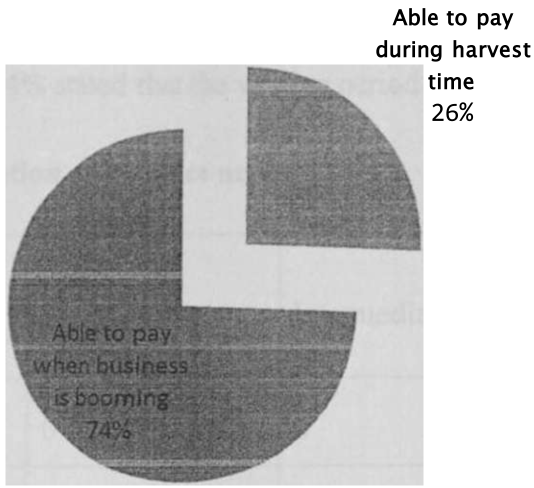
Table 4. 10: If seasonality of increase affected payment regime

Response	Frequency	Percentage (%)
Yes	37	89
No	4	11
Total	41	100

Source: Research findings

The study sought to find out if seasonality of increase affected payment regime. According to the findings, 89% of the respondents indicated that seasonality of increase affected payment regime while 11% of the respondents indicated that seasonality of increase did not affect payment regime.

Figure 4.11: How seasonality affected repayment



Source: Research findings

The study sought to find out how seasonality affected repayment. According to the findings, 74% of the respondents indicated that clients were able to pay when business is booming and 26% of the respondents indicated that clients were able to pay during harvest time. Frequent repayment also means that at the time of the first payment, the rewards (typically access to future credit) are further away from the repayment decision and thus more heavily discounted (Ghatak, 2009)

Table 4. 11: Waiting period before one can borrow upon joining the MF1 scheme

Period	Frequency	Percentage (%)
Days	4	11
Months	35	85
Years	2	4
Total	41	100

Source: Research findings

The study sought to find out the waiting period before one can borrow upon joining a MFI scheme. According to the findings, 85% of the respondents stated that the waiting period before one can borrow upon joining a MFI scheme was months, 11% stated that the waiting period was days and 4% stated that the waiting period before one can borrow was years.

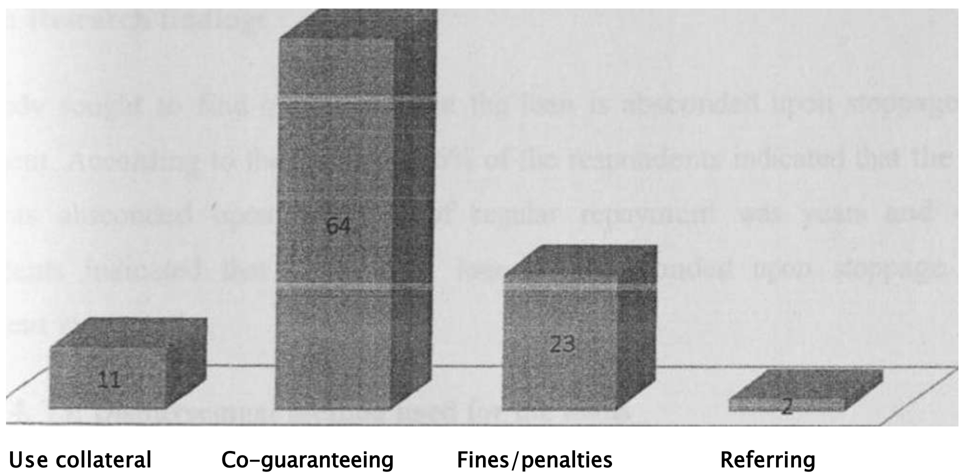
Table 4. 12: Description of product needs

Product needs	Very strong	Strong	Intermediate	Weak	Very weak	mean	stdev
Consumption	0	1	2	15	23	1.5	0.1
Social	1	1	3	4	32	1.4	0.3
Capital investment	4	24	9	4	0	3.7	0.1
Business working capital	24	9	4	2	2	4.2	0.2
Emergency	2	9	24	4	2	3.1	0.5
School fees	17	9	9	4	2	3.9	0.2
Medical	2	2	18	15	4	2.6	0.1

Source: Research findings

The study sought to find out the description of product needs. According to the findings the respondents described business working capital as very strong as shown by a mean of 4.2, the respondents described school fees as strong as shown by a mean of 3.9, the respondents described capital investment as strong as shown by a mean of 3.7, the respondents described emergency as intermediate as shown by a mean of 3.1, the respondents described medical as intermediate as shown by a mean of 2.6, the respondents described consumption as weak as shown by a mean of 1.5 and the respondents described social as very weak as shown by a mean of 1.4. Microfinance is also a powerful tool for achieving higher levels of financial inclusion in developing economies thereby facilitating efficiency and equity benefits. Microfinance also provides opportunities and attracts private capital flows. Regional networks of microfinance service providers can provide useful entry points for action in key economies (Conroy, 2008) and .((Mosley and Rock 2004)) state that microfinance services often enhance human capital through increased spending on education and health that may extend to poor households through intra household and inter-generational effects.

Figure **4. 12: Mechanism or incentive offered to ensure that those who take loan repay** in **due time**



Source: Research findings

The study further sought to find out mechanism or incentive offered to ensure that those taking loan repay in due time. According to the findings, respondents indicated that 64% of the MFIs offered co-guaranteeing to ensure that those who take loan repay in due time, 23% of the MFIs offered fines/penalties to ensure that those who take loan repay in due time, 64% of the MFIs used collaterals to ensure that those who take loan repay in due time and 2% of the MFIs offered referring to ensure that those who take loan repay in due time. Frequent repayment also means that at the time of the first payment, the rewards (typically access to future credit) are further away from the repayment decision and thus more heavily discounted (Ghatak, 2009).

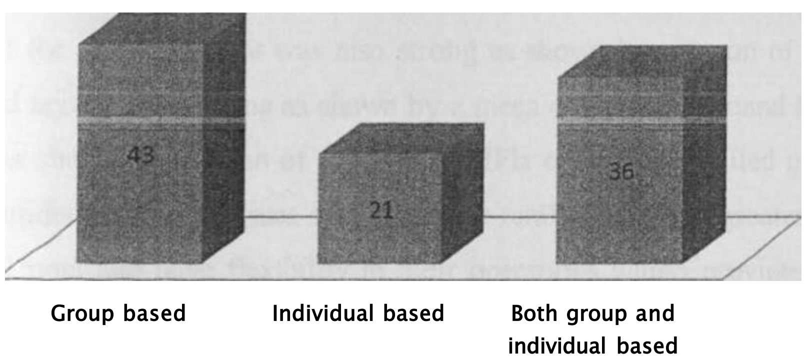
Table 4. 13: Period that the loan was absconded upon stoppage of regular repayment

Period	Frequency	Percentage (%)
Months	2	4
Years	39	96
Total	41	100

Source: Research findings

The study sought to find out period that the loan is absconded upon stoppage of regular repayment. According to the findings, 96% of the respondents indicated that the period that loan was absconded upon stoppage of regular repayment was years and 4% of the respondents indicated that period that loan was absconded upon stoppage of regular repayment was months.

Figure 4. **13: Disbursement method used for the loans**



Source: Research findings

The study sought to find out disbursement method used for loans. From the findings, 43% of the respondents indicated that disbursement method used for the loans was group based, 36% of the respondents indicated that disbursement method used for loans was both group based and individual based and 21% of respondents indicated that disbursement method used for loans was individual based.

4.4.2 Savings Serv ices

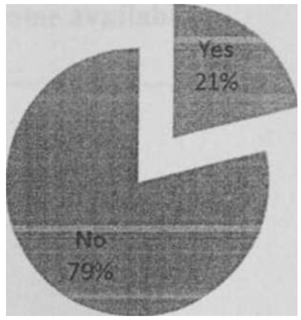
Table 4. 14: Demand for saving/deposit products

Product	very strong	strong	intermediate	Weak	very weak	mean	stdev
Savings account	15	9	9	4	4	3.6	0.1
Investment account	9	9	15	4	4	3.3	0.3
Custodial account	2	4	9	24	2	2.6	0.2
Current account	4	2	9	24	2	2.6	0.6
Equity account	2	9	24	4	2	3.1	0.1

Source: Research findings

The study also sought to find out the demand for saving/deposit products. According to the findings, the respondents indicated that demand for savings account was strong as shown by a mean of 3.6, while demand for investment account was strong as shown by a mean of 3.3. Demand for equity account was also strong as shown by a mean of 3.1; while demand for custodial account was strong as shown by a mean of 2.6 and demand for current account was strong as shown by a mean of 2.6. Many MFIs operate in limited geographical area, have greater understanding of issues specific to the rural poor, enjoy greater acceptability amongst the rural poor and have flexibility in their operations which provides a level of comfort to their customers at the lower income brackets (Rangarajan, 2008). Microfinance is also a powerful tool for achieving higher levels of financial inclusion in developing economies thereby facilitating efficiency and equity benefits.

Figure 4. 14: Whether clients were able to access their savings account on a timely basis



Source: Research findings

The study sought to find out whether clients were able to access their savings account on a timely basis. According to the findings, 79% of the respondents indicated that the clients were not able to access their savings account on a timely basis while 21% of the respondents indicated that the clients were able to access their savings account on a timely basis.

Table 4.15: Why clients were not able to access their savings account on a timely basis

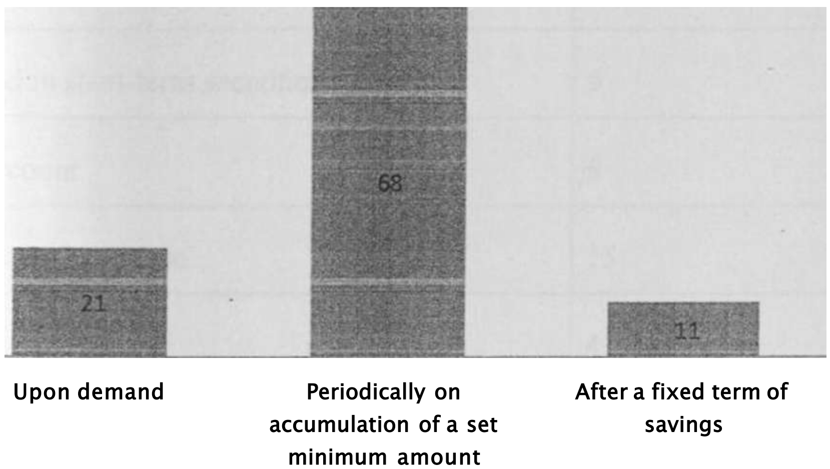
Reason	Frequency	Percentage (%)
They are often tied up in savings	4	10
Savings act as collateral	31	75
Amount only available at the end of saving cycle	6	15
Total	41	100

Source: Research findings

The study sought to find out why clients were not able to access their savings account on a timely basis. According to the findings, 75% of respondents indicated that clients were not able to access their savings account on a timely basis because savings act (served) as collateral, 15% of the respondents indicated that clients were not able to access their savings account on a timely basis because of the amounts were only available at the end of saving

cycle and 10% of the respondents indicated that clients were not able to access their savings **account** on a timely basis because they were often tied up in savings.

Figure **4. 15: When savings become available**



Source: Research findings

The **study** sought to find out when savings become available. According to the findings. 68% of the respondents indicated that savings become available periodically on accumulation of a **set** minimum amount, 21% of the respondents indicated that savings become available upon demand and 11 % of the respondents indicated that savings become available after a fixed **term** of savings.

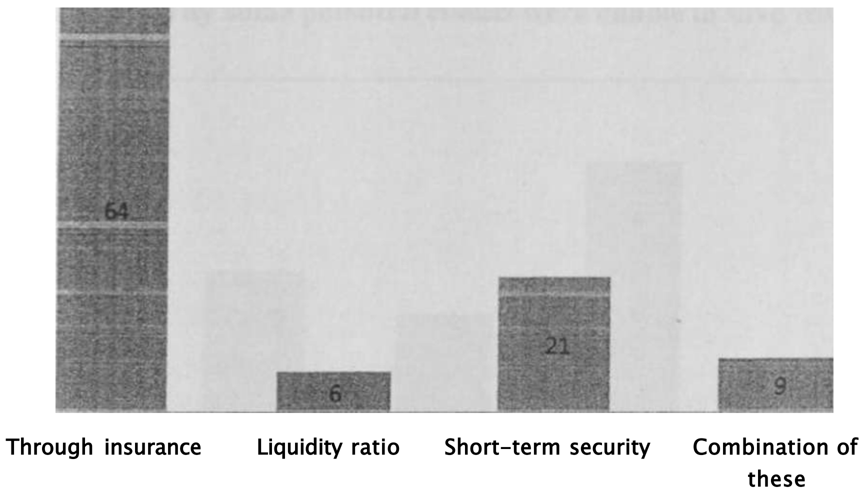
Table 4. 16: Where client savings kept to minimize the risk of theft

Mode of savings	Frequency	Percentage (%)
Group bank account	3	7
Lend out to members	9	22
Invested in short-term securities	5	12
MFI account	9	22
Combination of these	15	37
Total	41	100

Source: Research findings

The study further sought to find out where clients savings were kept to minimize the risk of thefL According to the findings, 22% of respondents indicated that clients savings were lend out to members to minimize the risk of theft, 22% of the respondents indicated that clients savings were kept in MFIs account to minimize the risk of theft, 12% of the respondents indicated that clients savings were invested in short-term securities to minimize the risk of theft and 7% of the respondents indicated that clients savings were kept in group bank account to minimize the risk of theft while 37% accounted for a combination of the saving measures.

Figure 4. 16: How MFI safeguard clients' savings against loss/fraud



Source: Research findings

The study sought to find out how MFIs safeguard clients' savings against loss/fraud. According to the findings, 64% of the respondents indicated that MFIs safeguarded clients' savings against loss/fraud through insurance, 21% through short term security, 9% through the combination of insurance, short-term security and liquidity ratio while 6% of the respondents indicated that MFI safeguarded clients' savings against loss/fraud through liquidity ratio.

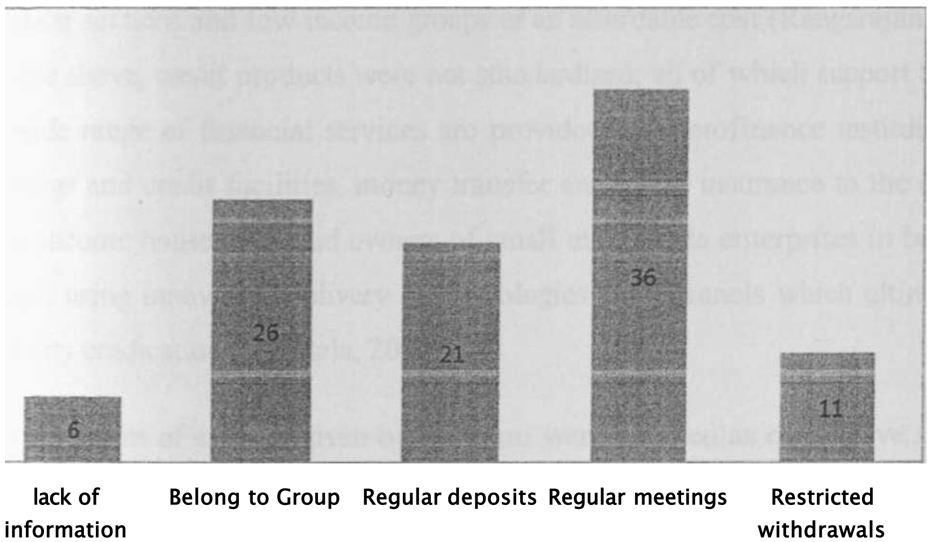
Table 4. 17: If there were some potential clients unable to save with the MFIs

Response	Frequency	Percentage (%)
Yes	38	93
No	3	7
Total	41	100

Source: Research findings

The study sought to find out if there were some potential clients who were unable to save with the MFIs. According to the findings, 93% of the respondents indicated that there were some potential clients who were unable to save with the MFIs while 7% of the respondents indicated that there were no potential clients unable to save with the MFIs.

Figure 4. 17: Why some potential clients were unable to save with the MFIs



Source: Research findings

The study sought to find out why some potential clients were unable to save with the MFIs. According to the findings, 36% of the respondents indicated that some potential clients were unable to save with the MFIs due to regular meetings, 26% of the respondents indicated that some potential clients were unable to save with the MFIs since they belong to group, 21% of the respondents indicated that some potential clients were unable to save with the MFIs due to regular deposit, 11% of the respondents indicated that some potential clients were unable to save with the MFIs due to restricted withdrawals and 6% of the respondents indicated that some potential clients were unable to save with the MFIs due to lack of information.

4.5 Discussion of findings

Results of the research showed the following in the operational activities of microfinance institutions (MFIs) in Nairobi. MFIs targeted clients from diverse financial backgrounds such as traders, farmers, hawkers and beneficiaries of government credit programs. They offered savings and credit services, cheques clearance, money transfer and standing order services. In terms of legal status, the MFIs operate either as commercial entities, full banking institution, community or government programs. MFIs sources of funding were found to be that of members' savings, funds from donors and internally generated revenues. MFIs also tailored their credit products which matched the concept that state the objective of financial inclusion as the comprehensive inclusion that provides a holistic set of services encompassing access to financial services, timely and adequate credit where needed by vulnerable groups such as weaker sections and low income groups at an affordable cost (Rangarajan, 2008). In addition to the above, credit products were not standardized; all of which support the proposition that a wide range of financial services are provided by microfinance institutions; ranging from savings and credit facilities, money transfer and micro insurance to the economically poor, low income households and owners of small micro scale enterprises in both rural and urban areas, using innovative delivery methodologies and channels which ultimately contribute to poverty eradication (Mwatela, 2008).

Determinants of amount given out as loans were revealed as cumulative savings, collaterals, previous loan experience and group guarantees. The duration of borrowing (Loan period) ranged between couple of days and a year; minimum loan allowable were Kes5,000.00, Kes 10.000.00 and Kes50,000.00 while maximum loan allowable found to be Kes 1,000,000.00, Kes500,000.00, Kes5,000,000.00 Kes250,000,000.00 respectively. Interest rates (Kes) annualized were also found to be 12%, 15%, 24%, and 32% and were either fixed or variable. Other charges on loans were withdrawal fees; penalties, insurance and ledger/legal fees. The research results also showed that MFIs products did not meet the expectations of some clients because they had either wanted loans for a longer period, more loans with less security or unsecured loans.

The study also revealed that a greater percentage of MFIs did not required collateral to provide loans while others did with collateral types such as group guarantee, livestock, household items and land, grain and crop/farm produce. Seasonality of increase affected payment regime positively meaning that credit customers paid on their loans during booming seasons. Waiting period before one borrows upon joining MFI schemes ranged between days to a year. Need for products was very strong for working capital; strong for school fees, capital investment; intermediate for emergency and medical; weak need for consumption and very weak for social needs. Mechanisms or incentives used to ensure repayment of loan were found to be co-guaranteeing, fines/penalties, collaterals and referring while it took years for loan to be absconded upon stoppage of regular repayments. Demands for savings/deposit products in median terms were described in different categories as strong for savings account.

investment account, equity account, custodial account and current account with varying **means.** According to Fischer and Ghatak (2009) the behavioral factors motivating frequent repayment for loans can also create demand for commitment to savings products, ranging **from** ROSCAs to formal financial products with time or amount targeted and for a time, the excitement surrounding micro lending seemed to crowd out interest in savings behavior, but interest has flooded back.

The study also found that higher percentage of clients did not have access to their savings accounts on a timely basis because the savings act (serve) as collateral or were only available at the end of the saving period. Savings also become available periodically on the accumulation of a set minimum amount. The research also found that to minimize the risk of theft, clients savings were lend out to members, kept in MFIs account, invested in short-term securities, kept in group bank account or a combination of the saving measures. To safeguard clients' savings against loss/fraud, MFIs also used insurance, short term security or a combination and liquidity ratio. Finally, the research found that some potential clients were unable to save with the MFIs either because of regular meetings; clients belonging to other group, regular deposit requirement, restricted withdrawals or lack of information about the MFIs operations.

Outcomes of the research were determined to be in consonance with existing body of knowledge on financial inclusion practices by microfinance institutions (MFIs) as discussed in the literature review. Therefore, the findings were found to be consistent with the current theory on financial inclusion practices and the accompanying challenges.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This section provides summary of the findings from chapter four, conclusions and recommendations based on the objectives of the study. The objective of this study was to investigate the effectiveness of microfinance institutions in implementing financial inclusion in Nairobi.

5.2 Summary

Many policymakers have made financial inclusion a priority on their development agenda with a growing list of countries that have specific financial inclusion policy mandates reaching different sector of government. Several of these countries in the developing world including Kenya are now playing leading roles in providing access to financial resources to their citizens through various financial institutions. One group of those financial institutions is the microfinance institutions (MFIs) which have always played the traditional role of providing financial services to the poor and low income earners who are often excluded from mainstream financial sector. However, there are some differences between theories and empirical studies done by various writers and practioners within the industry on the role of MFIs in the provision of access to financial services and poverty alleviation. The study was therefore aimed at establishing the effectiveness of MFIs in the financial inclusion process in Nairobi. Determinants that represent the extent to which MFIs activities fit into the financial inclusion process were examined to show how effective they are providing access to financial resources.

The study found determinants of amount given out as loans to be cumulative savings, collaterals, previous loan experience and group guarantees. The duration of borrowing (Loan period) ranged between couple of days and a year; minimum loan allowable were Kes5,000.00, Kes 10,000.00 and Kes50,000.00 while maximum loan allowable found to be Kes 1,000,000.00, Kes500,000.00, Kes5,000,000.00 Kes250,000,000.00 respectively. Interest rates (Kes) annualized were also found to be 12%, 15%, 24%, and 32% and were either fixed or variable. Other charges on loans were withdrawal fees; penalties, insurance and

ledger/legal fees. The research results also showed that MFIs products did not meet the expectations of some clients because they had either wanted loans for a longer period, more loans with less security or unsecured loans.

The study also revealed that a greater percentage of MFIs did not required collateral to provide loans while others did with collateral types such as group guarantee, livestock, household items and land, grain and crop/farm produce. Seasonality of increase affected payment regime positively meaning that credit customers paid on their loans during booming seasons. Waiting period before one borrows upon joining MFI schemes ranged between days to a year. Need for products was very strong for working capital; strong for school fees, capital investment; intermediate for emergency and medical; weak need for consumption and very weak for social needs. Mechanisms or incentives used to ensure repayment of loan were found to be co-guaranteeing, fines/penalties, collaterals and referring while it took years for loan to be absconded upon stoppage of regular repayments. Demands for savings/deposit products in median terms were described in different categories as strong for savings account, investment account, equity account, custodial account and current account with varying means.

The study in addition found that higher percentage of clients did not have access to their savings accounts on a timely basis because the savings act (serve) as collateral or were only available at the end of the saving period. Savings also become available periodically on the accumulation of a set minimum amount. The research revealed that to minimize the risk of theft, clients savings were lend out to members, kept in MFIs account, invested in short-term securities, kept in group bank account or a combination of the saving measures. To safeguard clients' savings against loss/fraud, MFIs also used insurance, short term security or a combination and liquidity ratio. Finally, the research found that some potential clients were unable to save with the MFIs either because of regular meetings; clients belonging to other group, regular deposit requirement, restricted withdrawals or lack of information about the MFIs operations.

Outcomes of the research were detennined to be in consonance with existing body of knowledge on financial inclusion practices by microfinance institutions (MFIs) as discussed in the literature review. Therefore, the findings were found to be consistent with the current theory on financial inclusion practices and the accompanying challenges. This outcome supports the fact that MFIs in Nairobi are effective in the financial inclusion process.

5J Conclusion

Findings of the research indicates that microfinance institutions operating in Nairobi appreciate and embrace Financial inclusion practices similar to those proposed in microfinance and financial inclusion theories as reported in the literature review and from other studies conducted in the microfinance industry and financial inclusion practices. The study revealed that financial inclusion was formally practiced at acceptable levels at the various MFIs. MFIs provided various credits and savings products and adopted financial management strategies such as measures taken to safeguard client's savings, limitations on borrowings, consumers' education, and other risk management activities which promote financial inclusion. MFIs credits and savings products were designed in such a way that they meet varying needs of individuals and businesses of different income levels. The findings also revealed that despite the efforts by the MFIs to carry out financial inclusion practices, there remains some level of challenges which has the propensity to slow down the progress made by the MFIs. The challenges are both external and internal and must be addressed in order to sustain the gains made by microfinance institutions in the financial inclusion process.

5.4 Limitations of Study

The study may have the following limitations due to the nature of the methodology or the microfinance industry. First, some sections of the questionnaires were not answered by respondents making it difficult to obtain and analyze data pertaining to those parts. This cause a level of non-response which may impact the validity and reliability of the results though not to material extent.

Another limitation is that certain financial institutions such as SACCOs, Cooperatives, Self-Help Groups and others engaged in microfinance sector were categorized as informal even though they are carrying out microfinance activities. These institutions are deeply engaged in microfinance activities such as micro credits, micro savings and catering to the financial needs of a substantial proportion of the population of Nairobi and Kenya. This legal restriction has made it difficult for these institutions to be included in the study of MFIs while they are engaged in providing similar or identical services as the MFIs.

5.5 Recommendations for Policy

The study established that the demands for credits and saving products offered by MFIs are high among the population by the strong indications in the analyses. The study showed that MFIs provide flexible and affordable credits products for investments, emergency financial needs which are critical to the success of financial inclusion. The indication of high demand for working capital, capital investments and school fees by strong means also denotes that MFIs can be used as vehicle for the promotion of financial inclusion. The variety of risk management techniques such as co-guaranteeing, collateral relatively lower than that required by the formal banking sector and the use of accumulated savings as collateral are further indications of the ease with which MFIs can be utilized to provide easy access to financial resources by the poor and low income earners to be financially included

The government, donors and private investors should therefore increase their financial support to MFIs since these institutions possess the requisite ability and well position to reach out to the poor who are the prime target for financial inclusion. MFIs should also diversify their credit products to ensure that their products serve a large range of clients and tailor their credit services and standardize same to focus essential industries that are critical to economic and social enhancement. MFIs should use cumulative savings as determinant for amount given out as loans since it is the surest guarantee for maintaining mutual trust between MFIs as lenders and borrowers. Clients should be encouraged to increase their savings thus increasing their portfolio and at the same time facilitate improvement in MFIs liquidity and reduce cost of credits.

The study further recommends that MFIs calculate interest using reducing balance interest calculation and reduce other charges on loan and withdrawal fees to permit greater participation by clients in the loans and savings process. Products offered by MFIs should be designed to meet customer's expectation and use guarantors as collateral for borrowers since many of the target clients of MFIs do not possess physical collateral. Seasonality of increase affected payment regime positively. The booming period should therefore be utilized by MFIs to encourage clients to make up for the low seasons. The waiting period before one can borrow upon joining the MFI scheme should be reduced to months as means of facilitating timely borrowings for short-term and other operational activities.

5.6 Recommendations for Further Studies

The study was aimed at determining the effectiveness of microfinance institutions in implementing financial inclusion in Nairobi to the exclusion of other financial institutions in both the formal and informal sectors. Given the critical roles these financial institutions such as the SACCOs, ASCAs, SHGs, Credit Unions and others play in the economic advancement in Nairobi and Kenya as a whole; especially the provision of financial services to the micro sector of the economy, the researcher recommends that further studies be conducted on these institutions to detennine their effectiveness in implementing financial inclusion in Nairobi.

There is a gap between theoretical and empirical studies within the microfinance industry. Some writers have come up with theories without empirical studies and vice versa. This mismatch has caused some level of disagreement among writers on the empirical basis for some theories about microfinance. To date this problem remains unresolved. I therefore recommend that a study be done to harmonize the differences.

Financial inclusion has been difficult to measure due to lack of adequate statistics. One major factor that cannot be reasonably established is the percentage of those excluded. This statistics would facilitate the setting up of target by policy makers for inclusion. Accordingly, a further study is needed to establish the percentage of the population that is excluded to assist policy makers in making decision on the kind of programs that will raise the population from poverty and get them included into the financial system.

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APPENDICES

Appendix I: Questionnaire

Survey of the role of xMFIs in financial inclusion (Survey of services offered by MFIs)

L Questionnaires for microfinance institutions (MFIs):

Name of MFI_

Address

Tel

E-mail

Street____

Date_

IL General information on MFI

Q1. Which year the MFI commence operation in Nairobi?

Q2. Who is your target client?

(1) Traders ( )

(2) Hawkers ( )

(3) Government credit program ( )

(4) Farmers( )

(5) Others (specify)

Q3. Which financial services do you offer as an MFI?

(1) Savings ( )

(2) Credit ( )

(3) Savings and credit services ( )

(4) Cheques clearance ( )

(5) Money transfer ( )

(6) Standing Order ( )

17) Other (specify)

Q4 What is the nature (setup) of your MFI?

(1)NGO ( )
(2) Bank ( )
(3) Government program ( )
(4) Community ( )
(5) Commercial ( )
(6) Other (specify)_

Q5. What are the main sources for funding?

(1) Members savings( ) (2) Donor funds ( ) (3) Internally generated revenue ( ) (4) Other (specify)

Q6 MFIs status for the past Five years:

Year	No. of group reg. with MFI	Membership of MFI	Member with loan	Loans disbursed	Proportion recovered	Compulsory savings required	Voluntary savings required	Ave percent drop out
2010								
2009								
2008								

III. Product Design

Q7. **Credit services**

What credit product is provided?

(1) Emergency (   )

(2) Consumption (   )

(3) Household supply (   )

(4) Investment   )

(5) Other (specify)

(A) Is the credit product:

(a) Tailored? (1)Yes(   ) (2)No(   )

(b) Standardized? (l)Yes(   ) (2)No(   )

What is the determinant of amount given out as loan?

(1) Collateral (   )

(2) Ability to pay(   )

(3) Previous loan experience(   )

(4) Guaranteeing(   )

(5) Cumulative savings(   )

(6) Other (specify)_

Duration of borrowing (Loan period)

(1) Days (   )

(2) Week (   )

(3) Months (   )

(4) Year (   )

Minimum loan allowable_

Maximum loan allowable

Interest rate ($) annualized

Kind of interest rate

(1) Fixed ( )

(2) Variable ( )

Mode of interest calculation

(1)Flat( )
(2) Reducing balance ( )

IV. Repayment scheme

Other charges on loan:

(0) None ( )

(1) Ledger/legal fee ( )

(2) Penalties ( )

(3) Insurance ( )

(4) Withdrawal fees ( )

(5) Combination ( )

(6) Other (specify)

Does your product meet customer's expectation?

(1) Yes ( )
(2) No ( )

If no, why is it not satisfactory?

(1) Want more with less sorority ( )

(2) Want loans for longer periods ( )

(3) Want unsecured loans ( )

(4) Other (specify)

Q8. Do you require collateral to provide loans?

(1) Yes ( )

(2) No ( )

Q9. If yes, what kind of collateral does your MFI accept from potential clients?

(1) Land( )

(2) Grain ( )

(3) Livestock ( )

(4) Group guarantee ( )

(5) Household items ( )

(6) Crop/farm produce ( )

(7) Other (specify)_

Q10. Does the seasonality of increase affect payment regime? 1) Yes ( ) 2) No ( )

Q11. If yes, how does it affect repayment?

(1) Able to pay during harvest time ( )

(2) Able to pay when business is booming ( )

(3) Other (specify)

Q12. What was your target for reaching out to clients?________________What percent of your target you were able to reach?_

Q13. Upon joining the MFI scheme, what is the waiting period before one can borrow?

(1) Days( )

(2) Months ( )

(3) Years ( )

Q14. How would you describe the product you offer? Rank

1. Very strong
2. Strong
3. Intermediate
4. Weak
5. Very weak

No.	Product needs	Demand
1	Consumption	
2	Social	
3	Capital investment	
4	Business working capital	
5	Emergency	
6	School fees	
7	Medical	
8	Other (specify)	

Q15. What mechanism or incentive do you offer to ensure that those who take loan repay in due time?

(1) Use collateral ( )
(2) Co-guaranteeing ( )
(3) Fines/penalties ( )
(4) Referring ( )
(5) Social stigmatization ( )
(6) Other (Specify)_

Q16. Upon stoppage of regular repayment, after what period do you suspect that the loan has been absconded?

(1) Days(   )

(2) Months (   )

(3) Years (   )

Q17. What disbursement method do you use for your loans?

(1) Group based (   )
(2) Individual based (   )
(3) Both group and individual based (   )
(4) Other (Specify)

SAVINGS SERVICES

Q18. What is the volume of savings deposits for the last five years?

No.	Year	Compulsory	Voluntary	Both running
1	2010			
2	2009			
3	2008			

Q19. Cunent savings Portfolio

Kind of saving accounts	Number of account holders	Amount accum. savings	Savings method	Which savings scheme is the most?	Duration of savings	Is there restriction on the amount saved?	If yes, what are the restrictions?	Interest rate per period

Q20. For each saving/deposit product, what is the demand? Please Rank as:

1. Very strong
2. Strong
3. Intermediate
4. weak
5. Very weak

No.	Product	1	2	3	4	5
1	Savings account					
2	Investment account					
3	Custodial account					
4	Current account					
5	Equity account					
6	Other (specify)					

Q21. Are clients able to access their savings account on a timely basis ?

(1) Yes( )

(2) No ( )

Q22. If no, why?

(1) They are often tied up in savings ( )
(2) Savings act as collateral ( )
(3) Amount only available at the end of saving cycle ( )
(4) Other (specify)_

Q23. If no, when do the savings become available?

(1) Upon demand ( )
(2) Periodically on accumulation of a set minimum amount ( )
(3) After a fixed term of savings ( )
(4) Other (specify)_

Q24. To minimize the risk of theft, where are clients savings kept?

(1) Group bank account ( )
(2) Lend out to members ( )
(3) Lend out to non-members ( )
(4) Invested in short-term securities ( )
(5) With group treasurer ( )
(6) MFI account ( )
(7) Combination of these ( )
(8) Other (specify)

Q25. How do you as MFI safeguard clients' savings against loss/fraud?

(1) Through insurance ( )
(2) Liquidity ratio ( )
(3) Short-term security ( )

(4) Combination of these ( )

(5) Other (specify)

Q26. Are there some potential clients who are unable to save with you?

(1) Yes( )

(2) No ( )

Q27. If no, why?

(1) Minimum balance too high ( )
(2) high charges ( )
(3) lack of information ( )
(4) Belong to Group ( )
(5) Regular deposits ( )
(6) Regular meetings ( )
(7) Restricted withdrawals ( )
(8) Other (specify)

Q28. Give some important lessons learnt in managing your MFI.

Thanks for participating in the survey and providing me with needed data for my project. I remain grateful for your kind gesture and generosity.

SCHOOL OF BUSINESS

Mba programme

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DATE. *J q m c* a ^ ^ / z

TO WHOM XT MAY CONCERN

The bearer of this letter ^ & P * A Z ^ "

Registration No

is a bona fide continuing student in the Master of Business Administration (MBA) degree program in this University

He/she is required to submit as part of his/her coursework assessment a research project report on a management problem. We would like the students to do their projects on real problems affecting firms in Kenya. We would, therefore, appreciate your assistance to enable him/her collect data in your organization.

The results of the report will be used solely for academic purposes and a copy of the same will be availed to the interviewed organizations on request.

Thank you

UNIVERSITY OF NAIROBI
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JMBA ADMINISTRATOR
MBA OFFICE, AMBANK HOUSE

APPENDIX II-AMFI MEMBERSHIP

This section contains 47 of 53 members that make up the Association of Microfinance Institutions of Kenya (AMFI-K) operating in Nairobi:

1. AAR Credit Services
2. Agakhan First Microfinance Agency
3. Blue Limited
4. Canyon Rural Credit Limited
5. Century DTM LTD(Interim)
6. Chartis Insurance
7. CIC Insurance
8. Co-operative Bank
9. ECLOF Kenya
10. Equity Bank
11. Faulu Kenya DTM Limited
12. Fusion Capital Ltd
13. Greenland Fedha Limited
14. IndoAfrica Finance
15. Jitegemea Credit Scheme
16. Jitegemee Trust Limited
17. Juhudi Kilimo Company Limited
18. K-rep Bank Ltd
19. K-rep Development Agency
20. KADET
21. Kenya Entrepreneur Empowerment Foundation (KEEF
22. Kenya Post Office Savings Bank
23. Kenya Women Finance Trust
24. Kilimo Faida
25. Micro Africa Limited
26. Micro Enterprises Support Fund(MESPT)
27. Microensure Advisory Services
28. Molyn Credit Limited
29. Musoni

30. Ngao Credit Ltd
31. 0ikocredit
32. One Africa Capital Limited
33. Opportunity International
34. Platinum Credit Limited
35. Rafiki Deposit Taking Microfinance Ltd
36. Remu DTM Limited
37. Renewable Energy Technology Assistance Programme (RETAP)
38. Rupia Limited
39. Select Management Services Limited
40. SISDO
41. SMEP DTM Limited
42. Sumac Credit Ltd
43. Swiss Contact
44. U & 1 Microfinance Limited
45. Uwezo DTM Ltd
46. Women Enterprise Fund
47. Youth Initiatives - Kenya (YIKE)