TO INVESTIGATE MICROFINANCE FACTORS AFFECTING PERFORMANCE OF MICRO AND SMALL ENTERPRISES FINANCED BY MICROFINANCE INSTITUTIONS IN MURANG'A TOWN

BY

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DECLARATION

This research project is my own work and has not been presented for a degree or any other course in any other institute or university.

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This research project is dedicated to my wife Janet and my daughter Annabel. Thank you for your support, encouragement, prayers and the sacrifices you have made during the course of my studies. To my parents, thank you for laying a good foundation in my life.
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LIST OF ABBREVIATIONS AND ACRONYMS

DFIs- Development Finance Institutions.

G.D.P.- Gross Domestic Product.

GOK- Government of Kenya.

K-REP- Kenya Rural Enterprise Program.

MFI- Micro Finance Institutions.

M.F.M.I.- Microfinance Management Institute.

MSEs- Micro and Small Enterprises.

ROSCAs- Rotary saving and Credit Associations.

SACCOs- Saving and Credit Co operative Societies.
OPERATIONAL DEFINITIONS

Microfinance- Refers to small scale financial products and services such as cash loans, money transfers, direct deposits, savings, and insurance made accessible primarily to the MSEs.

Microcredit- Refers to any form of credit service offered to low-income individuals not traditionally serviced by the formal banking sector.

Microsavings-Refers to any form of savings product offered to low-income individuals not traditionally served by the formal banking sector.

Microinsurance- Refers to any form of arrangement that sees low-income individuals and businesses, not traditionally serviced by commercial insurance schemes, make contributions to a scheme in order to guard against specific risks.

Credit Cost- Processing fee and interest incurred on a loan issued by microfinance institution.

Micro and Small Enterprises- Businesses employing between 0-49 employees. This term will be used to cover a range of establishments in the formal and in the informal sector enterprises that employ less than 50 employees.

Performance- overall activities and operations performed by entrepreneurs in MSEs in strengthening their enterprises.

Group lending- Refers to the practice of issuing loans to individual members of small, Homogeneous groups. Participants self-select into groups which collectively guarantee loans issued to their members.

Individual lending- Refers to the practice of issuing loan to individual customers who are not necessarily members of a group.
ABSTRACT

The MSEs sector in Kenya plays an important role in the social-economic development of the country. Its significance can be seen in terms of contribution towards economic growth, employment creation, poverty eradication and development of an industrial base. However, despite the critical role played by the sector, it faces many challenges and constraints that include unfavorable policy environment and regulatory framework, limited access to financial services and markets, inadequate skills and technology and gender inequality among others. The objective of the study will be to investigate Microfinance factors affecting the performance of MSEs financed by microfinance institutions in Kenya, with a special reference to MSEs in Murang’a Town in Murang’a County. Specifically, the research aims to attain the following objectives; find out whether business training affects performance of Micro and Small Enterprises, examine whether microfinance credit cost affects the performance of Micro and Small Enterprises, establish whether the microsavings and microinsurance products offered by microfinance institutions affect performance of Micro and Small Enterprises and finally, assess whether loan lending methods affect performance of Micro Small Enterprises. The study is intended to be of help to individual entrepreneurs, microfinance institutions, potential investor’s government, as well as researchers. Literature review includes theories on MSEs development, microfinance revolution, general empirical review on Microfinance and MSEs performance and Microfinance factors affecting MSEs performance. The study will use stratified random sampling and then apply the simple random sampling to select strata. 60 respondents will be involved in the study. Data will be gathered using questionnaires. The researcher will administer the questionnaire to respondents assisted by hired personnel. The data will be analyzed using statistical package for social and sciences (SPSS). It will then be presented in tables, graphs, pie-charts and cross tabulations. Based on the findings, data and descriptive statistics will be provided as well as conclusions of the findings and recommendations.
CHAPTER ONE

INTRODUCTION

1.0 Background of Study

Access to finance is indisputably a vital factor for better firm performance and economic growth. Not surprisingly, financial development and economic growth across countries are highly correlated. In this respect, many scholars have ascribed the poor performance of numerous micro and small enterprises, particularly in Africa, to financial constraints (Levine 2006). Financial constraints refer to the inability of firms to obtain funds for profitable investment projects and growth. They result in inefficient allocation of firm resources and hampers growth. Small enterprises often fail to invest which hampers business growth (Beck et al 2002).

Access to credit enables the MSEs owner to cover some or all of the cost of capital equipment, expansion, or renovation of buildings. It helps existing or would-be entrepreneurs acquire the means for establishing or expanding a business (e.g. building premises and working capital) (ILO 2007). Credit also assists the business owner to cover cash flow shortage, to purchase inventories, to invest in new technology, expanding the market and being able to take advantages of suppliers’ discount. Without sufficient capital therefore, micro and small firms are unable to develop new products and services or grow to meet demand (Coleman 2000).

In recent years, there has been increasing recognition of the role microfinance can play in providing people living in poverty with basic financial services. The Monterrey Consensus, adopted in 2002, noted the key role of microfinance and microcredit for micro, small and medium-sized enterprises in strengthening the social and economic impact of the financial sector. The development of microfinance as a strategy to eradicate poverty was a central theme of the International Year of Microcredit in 2005 (Karlan 2008).

This study seeks to investigate microfinance factors affecting MSEs performance. Research in these areas -finance, performance and entrepreneurship- are important because entrepreneurship itself is indispensable to economic development (Naude,
2010). The study will focus on micro and small enterprises (MSEs) that are found in Kenya. Specifically, the study will rely on data from microfinance clients that operate in Murang’a town.

1.1 Microfinance and its Role in Africa

A large percentage of people especially in developing countries have been ignored by the banking sector and are deprived of organised services such as loans, insurance, remittance and saving instruments. Based on the access to finance composite index developed by Honohan (2007), South of Saharan Africa has the lowest proportion, on the average, just about a fifth of the population have access to finance. It is then apparent that, one of the recent UN report argues that the overarching goal of financial inclusion requires the availability of a range of financial institutions offering a range of products and services at reasonable costs supported by legal and regulatory infrastructure (World Bank, 2007). In most scenarios, the poor are not seen to be ‘bankable’ by the formal financial sector and are uninsurable to the wide variety of risks they face (Morduch 1999; Dercon 2002).

People living in poverty, like everyone else, need a diverse range of financial services to run their businesses, build assets, smooth consumption, and manage risks. Microfinance offers a mechanism by which, organisations such as banks, non-governmental organisations (NGOs), non-bank financial institutions (NBFIs) and governments offer financial services which include loans, savings, money transfer services and micro insurance to the poor. In developing countries there are a big number of individuals who are financially under served. However, microfinance programmes and institutions have been recognized globally as a prospective component of strategies of development organisations, governments, and societies to promote enterprises in developing countries (Hulme, 2005).

According to Ledgerwood (1998), MFIs are organisations with a goal to serve the needs of un-served or underserved markets as a means of meeting development objectives. Through serving these groups, the owner of micro and small enterprises (MSEs) are expected to accumulate wealth and therefore grow after time.
Specifically, microfinance institutions provide a broad range of services including deposits, loans, payment services, money transfer and insurance to the poor/low-income households and their enterprises. In addition, some of microfinance institutions provide non-financial services such as training, business advice, market assistance and counseling to their clients (CIDA 1999). It is from this standing that microfinance institutions are seen to be a critical element to the poor and low income earners in developing economies because their services target the clients who have been excluded from other formal institutions.

In Africa, during the past two decades microfinance schemes emerged as an alternative to ensuring access to financial services for small borrowers. Due to the limited success achieved by top-down policies and programmes as well as the nonsustainability of previous government-backed credit programmes specially designed for the poor, many countries in Africa have followed the microfinance pathway (Aryeetey 2008).

Barnes et al (2004) notes that Small enterprises and most of the poor population in sub-Saharan Africa have very limited access to deposit and credit facilities and other financial services provided by formal financial institutions. For example, in Ghana and Tanzania, only about 5-6 percent of the population has access to the banking sector. This lack of access to financial services from the formal financial system is quite striking, when one considers that in many African countries the poor represent the largest share of the population and that the informal sector is an important part of the economy.

To meet unsatisfied demand for financial services, a variety of microfinance institutions have emerged over time in Africa. Some of these institutions concentrate only on providing credit, others are engaged in providing both deposit and credit facilities, and some are involved only in deposit, (Charitoneko 1998).

1.1.1 Emergence of Microfinance in Kenya

As an industry, micro finance is a relatively new phenomenon in Kenya, with a few agencies starting about 20 or so years ago but the sector gaining the status of an
industry only in the last 10 years. Kenya Rural Enterprise Programme (K-REP) can be considered the pioneer of NGO micro-finance in Kenya. The Kenya Rural Enterprise Programme (K-Rep) was established in 1984 by World Education, Inc., a United States based private voluntary organization, with funding from the United States Agency for International Development. It is now one of the most innovative and successful microfinance schemes in Africa. K-Rep provides financial services to the poor who are typically excluded from the formal financial sector, thereby generating income and employment opportunities for low-income people (Dondo et al 2000).

The experimental and financing activities of K-REP have had far-reaching consequences, influencing the outreach modalities and outreach by other microfinance programmes in Kenya. With generous support from USAID, K-REP was designed as an intermediary NGO in 1984 to provide credit and technical assistance to other NGOs in Kenya. Due to the pioneering and supportive roles of K-REP as well as donors much appreciating NGOs imitating the Grameen Bank approach, Kenya witnessed the emergence of quite some NGO-micro-finance agencies in the 1990s, using adapted versions of the Grameen Bank group-lending model. In this connection, one might say that Kenya evolved as the Bangladesh of Africa (K-REP 2001).

Kenya’s microfinance industry has come a long way since the 1980s, and particularly since the landmark Microfinance Intermediaries Act of 2006. The country now has five deposit-taking microfinance intermediaries (MFIs) operating under a regulatory framework assessed by the Economist Intelligence Unit (EIU) as the best in Africa. Overall, the EIU rates Kenya as having the second best business environment for MFIs in all of Africa and one of the top ten in the world, (EIU2010).

1.1.2 Economic Growth, Employment and the Development of the MSE Sector in Kenya

The formal sector employment was particularly hit by the decline in economic performance in last decade. While the formal sector wage employment grew by 2.1% in 1998, this rate declined to 0.6% in 1999, to 0.4% in 2000, and recorded a negative growth rate of -1.1% in 2001 (Republic of Kenya 2002). As the formal sector has declined, the informal sector has become increasingly important in the Kenyan
The share of employment between the formal and the informal sectors has changed drastically since then, with the latter overtaking the former in employment absorption. During the last decade, the growth rate in the informal sector’s employment has remained above that of the formal sector. This has seen the sector’s share in total employment rise from 16% in 1980, to 63.6% in 1997 and to 70% in 2000, (GOK 2002).

According to the Economic Survey by the Government of Kenya (2003), employment within the MSE sector increased from 4.2 million in 2000 to 5.1 million in 2002; with the informal sector accounting for 70.4 per cent of total employment opportunities. In 2001, the informal sector accounted for 72.8 per cent of total employment opportunities. This percentage rose to 74.3 per cent in 2002 and 76.5 per cent in 2004 (GOK Economic Survey, 2005, p.73). The table below summarizes this trend.

**Employment Generation in Kenya by MSEs 2000-2004**

<table>
<thead>
<tr>
<th>Year</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
</tr>
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<tbody>
<tr>
<td>Contribution in Percentage</td>
<td>70.4</td>
<td>72.8</td>
<td>74.3</td>
<td>75.5</td>
<td>76.5</td>
</tr>
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The dramatic increase in the contribution of MSEs to employment was largely attributed to retrenchment in both public and private sectors. The informal sector, within which most of the MSEs fall, is therefore an important component of the Kenyan economy towards employment generation. According to Kenyatta (2011), the government recognizes the critical role that MSEs play in the development agenda in terms of Employment creation, support to industrialization and economic growth.

The MSEs are therefore important in the economy for wealth and employment creation through increasing incomes and the high contribution to GDP (Republic of Kenya 2005). However, even with this growing percentage, not many micro-enterprises (70 per cent of which are women’s) grow into small-scale enterprises to significantly contribute to employment creation and economic growth.
1.2 Statement of the Problem

Over the past decades microfinance has received much attention as an instrument to foster entrepreneurship in the MSEs sector by simultaneously tackling financial constraints. However, in Kenya, policies and strategies designed by MFIs to boost credit and finance services to the MSE sector have been formulated in the absence of reliable information such as data on magnitude of the MSEs sector, characteristics of MSE operators and factors influencing the growth and dynamics of the sector (GOK-sessional paper 2, 2005).

Cook and Nixson (2005) surveyed the literature on finance for MSEs and observed that most research on MSEs is concerned with the industrial countries. There is much less literature on developing countries, in part because basic data availability is much sparser. They identify several key research questions which require investigation. Among these they particularly note that little is known about the relationships between the financing of MSEs and their ownership characteristics, size, and performance.

Although the lack of growth of many micro and small enterprises (MSEs) in African economies has been widely studied, only recently studies have attempted to examine the impact of micro finance on firm performance. A study by Karlan and Zinman (2008) based on data from a South-African micro-lender shows that in the medium run access to credit to marginal borrowers improved their income, job retention, and other composite measures in a positive manner. Another interesting study by Banerjee et al (2009) does not find any conclusive impact on profits.

Dupas and Robinson (2009) found that market vendors in Kenya who received credits enhanced their profitable investments. The assumption has been that firms with access to formal credit sources are more likely to perform well as a result. Certainly, there is at least some empirical support for it. However, MSEs performance and growth are also influenced by factors not related to credit, such as entrepreneurial skill or the presence of human capital and opportunities in the subsector in which the firm operates.
In general, knowledge about the achievements of microfinance initiatives remains not only partial but is also highly contested (Hulme, 2005). Few empirical studies have explicitly tested the positive link between microfinance and MSE performance. The findings from one econometric study, based on a random sample of 225 MSEs producing garments in Nairobi, Kenya, suggests that further research is needed (Akoten, Sawada, & Otsuka, 2006). The purpose of this study is therefore to investigate microfinance factors affecting performance of Micro and Small Enterprises (MSEs) funded by Microfinance Institutions in Kenya using data from those situated in Murang’a Town.

1.3 Objectives of the Study

1.3.1 General Objectives

This study aimed at investigating microfinance finance factors affecting performance of micro and small enterprises financed by microfinance institutions in Murang’a town in Kenya.

1.3.2 Specific Objectives

Specifically, the study sought to;

i) Find out whether business training affects performance of Micro and Small Enterprises.

ii) Examine whether microfinance credit cost affects the performance of Micro and Small Enterprises.

iii) Establish whether the microsaving and microinsurance products offered by microfinance institutions affect performance of Micro and Small Enterprises.

iv) To assess whether loan lending methods affects performance of Micro Small Enterprises.
1.4 Research Questions

i) To what extent does business training affects performance of Micro and Small Enterprises?

ii) How does microfinance credit cost affects the performance of Micro and Small Enterprises?

iii) How do the microsaving and microinsurance products offered by microfinance institutions affect performance of Micro and Small Enterprises?

iv) To what extent do loan lending methods affects performance of Micro and Small Enterprises?

1.5 Scope of the Study

The focus of the study was Murang’a Town in Murang’a County. This town has many micro and small enterprises and a substantive number of MFIS which include Faulu Kenya, Kenya Women Finance Trust (KWFT), Ecumenical Loans Fund (ECLOF) among others. Therefore, data was available as acknowledged by the many entrepreneurial activities in the area and the presence of these microfinance institutions.

1.6 Significance of the Study

The study will be of great help to individuals operating micro and small enterprises, potential entrepreneurs, microfinance institutions, banks, the government and researchers. MSEs will understand the business financing environment in which they operate in and in particular know the services which they can access from microfinance institutions and banks. Microfinance will use the findings to tailor their credit and other financial facilities to suit the needs of MSEs. This will help them attain high performance and growth. The government and other policy makers can use the findings to create an enabling financing environment through sound financial policies biased to meet the need for MSEs to attain high performance. Researchers can use the findings to identify areas that need further research.
1.7 Limitations of the Study

The study was limited by the fact that questionnaires were used to collect most of the data. Some respondents over-rated and while others under-rated their businesses on microfinance and performance. To overcome this, the interviewees were requested to be as honest as possible. Another limitation was that some entrepreneurs were not ready to respond either by choice or fear that their views could lead to victimization. Such entrepreneurs were made aware that the information they gave was going to be treated with a lot of confidentiality. Lastly, due to unavailability of adequate funds, the study was only limited to a sample population and not the whole population of MSEs in Murang’a town. This was only taken as a representative and hence information from some entrepreneurs was left out.

1.8 Assumptions of the Study

The study was based on the following assumptions; that microfinance would continue to allow and ease the conditions of the MSEs in acquiring the finances to start up or expand their businesses. The government policy that sought to implement policies for MSEs that foster a competitive environment and property rights protection in general was there to stay.

1.9 Chapter Summary

This chapter starts by giving the background of study. The role of finance in performance and growth of MSEs is highlighted. It’s noted that majority of MSEs in the developing world and particularly in Africa face financial constraints which affect their performance. The emergence of microfinance programs to play an important role in the financing of MSEs is highlighted. It’s followed by a brief note on the development and role of MSEs in the Kenyan economy. The statement of the problem for which this research is based upon is microfinance factors affecting performance of MSEs in Kenya, with a specific reference to those situated in Murang’a town. The other sections in this chapter include; research objectives and questions, scope of the study, significance of the study, limitations of the study and lastly the assumptions of the study.
CHAPTER TWO

LITERATURE REVIEW

2.0  Introduction

This chapter entails theoretical and empirical literature on micro and small enterprises and microfinance. The theoretical literature looks at development in theories on MSEs and microfinance. Empirical literature review follows and mainly focuses on microfinance practices which affect performance of MSEs. The chapter ends with a conceptual framework showing the relationship between dependent and independent variables.

2.1 Theories on MSEs Development

In the recent years important developments have taken place since the conceptualisation of the main issues relating to the MSE sector and subsequent theoretical work. Three theories have been put forward and are discussed in this section.

2.1.1 The Labour Surplus Theory

This theory argues that the driving force behind MSE development is excess labour supply, which cannot be absorbed in the public sector or large private enterprises and is forced into MSEs in spite of poor pay and low productivity. Arguably, the MSE sector develops in response to the growth in unemployment, functioning as a place of last resort for people who are unable to find employment in the formal sector. MSEs are expected to grow in periods of economic crisis, when the formal sector contracts or grows too slowly to absorb the labour force. However, when formal employment grows, the MSE sector is assumed to contract again and thus develops an anti-cyclical relationship with the formal economy. Particular attention has been paid to the behaviour of the MSE sector before and after the introduction of structural adjustment policies; examples include Daniels (1994) and Brand et al. (1995) for Zimbabwe and Meagher and Yunusa (1996) for Nigeria.
One re-interpretation of the labour surplus theory is the new literature on deagrarianisation, which relates the development of rural non-agricultural activities to the rural surplus labour, which, in turn, either supplements agricultural production with nonagricultural activities or migrants to the urban areas. However, there are some empirical problems with the unemployment theory of the growth and development of MSEs. First, there is lack of reliable and adequate data for researchers to test the hypothesis that MSEs absorb surplus labour from the public sector or large private enterprises and the hypothesis that increases in labour demand by MSEs has taken place before or after structural adjustment. Second, for the MSE sector to function as a place of last resort, it must be easily accessible. However, many studies have shown that is only the case for a handful of MSE activities. It is also sometimes argued that MSEs concentrate on trade because this requires less capital and knowledge than production (Bryceson, 1996; Bryceson and Jamal, 1997).

While it may be true that production requires more investment capital than trade, small scale trade is likely to require more working capital than small-scale production in order to secure a certain income. This is partly because value added is lower for the trader than for the producer, and partly because, in small-scale production, the customer will often be required to pay for the materials in advance, while the small-scale trader will have to give credit, probably more often than large formal retailers. Therefore, there are severe limitations to the extent to which the MSE sector can function as a place of last resort during crises.

2.1.2 Output-Demand Theory

The second theory for explaining the development of the MSE sector in developing countries is the output-demand theory. The theory postulates that a prerequisite for the development of MSEs is that there is a market for their products and services. Therefore, the MSE sector will tend to develop a cyclical relationship with the economy as a whole. However, MSEs will also develop in competition with large enterprises in the formal sector, and their development will be constrained by formal sector monopolies (Liedholm and Mead 1993).
Structural adjustment and other policies that limit such monopolies, and attempt to create more competition, will therefore be advantageous to the MSEs, because this may allow them to manufacturing enterprises and the larger, more resourceful and successful MSEs, which have a potential to grow into the formal economy. These studies propose strengthening of the MSEs through networks or via the creation of forward linkages with the formal economy, for example franchising and sub-contracting. This approach has not had much success in Africa due to problems of poor infrastructure and lack of trust between both parties. This creates an unstable environment and reduces the efficiency of the formal sector and access to factor markets for MSEs (Daniels 2001).

2.1.3 The Firm Growth Theory

The third theory, known as the firm growth theory, contends that, as a result of industrialisation and economic growth, MSEs are likely to disappear and be replaced by modern large-scale industry. This theory has, however, been shown to be inaccurate in the sense that MSEs do not normally compete directly with large enterprises; rather, they often tend to remain micro and small, co-existing with large multi-national companies, which phenomenon the World Bank has identified as the 'missing middle' (Ryan, 2005).

A study of Botswana, Kenya, Malawi, Swaziland and Zimbabwe, Mead (1994) found that most MSEs started with one to four employees and never expanded; less than 1% grew to exceed 10 employees. In addition, the MSEs tend to find niches in the factor and input markets where scale economies cannot be exploited by large enterprises. The most obvious activity where these niches exist is in distribution to areas or income groups where their costs would be prohibitively high for large enterprises.

However, in a literature survey on macro analyses of micro enterprises in developing countries, Liedholm and Mead (1993) came to the conclusion that macro-level empirical evidence indicates that, as aggregate per capita income increases, there is a systematic pattern of evolution of MSEs towards larger firms based in larger localities, producing more modern products. Nevertheless, critics of this view argue
that analyses on MSE development must take account of differences in their efficiency, the type of influence MSEs exercise in society, linkages between small and large enterprises, the changing roles of women entrepreneurs, differences in the level of education in the labour force and other socio-economic differences. In all, each of the three theories has been modified into some variants; however, one of the important elements common to all the theories and variants is the proposition that the growth of MSEs can contribute to poverty reduction.

2.2 The Microfinance Revolution

The microfinance revolution was introduced into the development economics arena slightly more than two decades ago. However, the widespread adoption of the microfinance model did not occur until the early 1990s. Since the mid 1990s, microfinance programmes and institutions have become an increasingly important component of strategies to promote MSE development in developing countries, and specifically to reduce poverty (Morduch, 1999).

Microfinance initiatives emerged as an alternative to the well documented failures of government rural credit schemes to reach small farmers (Hulme and Mosley, 1996) and the formal banking sector to provide services to low-income households. They pay close attention to the incentives that drive efficient performance (Morduch, 1999) in the context of small transactions and large numbers of clients. Many MFIs use group-based lending approaches and thus reduce the administrative costs (or transfer them to clients) of gathering information, contract design and enforcement of credit transactions, including loan recovery. Over time the microfinance sector has become less the domain of NGOs and non-profits and more the domain of commercial organisations.

According to Hulme (2005), microfinance programmes and institutions have been subjected to rigorous statistical analyses based on sample surveys. Microfinance activities have also been subjected to considerable impact assessment studies, focusing on multi-method impact assessments as well as participatory approaches. Specifically, almost all microfinance programmes assume that intervention will
change human behaviours and practices in ways that lead to the achievement of desired outcomes.

Sebstad and Chen (1996) note that the provision of a microfinance package of technical assistance and a loan is intended to increase household income which in turn may lead to greater household economic security, and thus lead to positive changes in the morbidity and mortality of household members, in educational and skill levels and in future economic and social opportunities.

According to Hulme (2005), knowledge about the achievements of microfinance initiatives remains not only partial but also highly contested. On the one hand, some studies argue that microfinance has very beneficial economic and social impacts (Holcombe 1995 and Hashemi and Schuler 1997). On the other hand, some studies tend to caution against such optimism and argue that microfinancing is associated with some negative impacts (Wood and Sharrif 1997). Between the polar sides of the dichotomy are some studies which clearly point out the beneficial impacts but also argue that microfinance does not assist the poorest; (Hulme and Mosley 1996) and Mosley and Hulme 1998).

Notwithstanding the application of these diverse methods and increased research activity in this area, it is still not very clear that microfinance is a panacea for poverty. To shed light on these issues, the microfinance literature has recently focussed on measuring the impact of credit on household welfare (Hulme, 2005). It is argued that credit contributes positively to household welfare through improving household production or smoothing consumption over time. Specifically, it is shown that although most credit programmes may not serve the poorest of the poor, all categories of the poor may be able to benefit through increased income and reduced vulnerability to ‘shocks’, as noted in Khandker (1998, 2003).

The theoretical literature on microfinance has been dominated by two strands. In the first strand, a generic theoretical model of microfinance activities tends to feature three sets of agents: households (potential borrowers), formal lenders and informal
lenders (such as money lenders, relatives, friends and ROSCAs). These markets are characterised by high lending transaction costs and lack of collateral when farmers do not own their own land. As a consequence, borrowers are charged high interest rates. Households consist of borrowing and non-borrowing households; they may borrow from formal lenders, informal lenders or both in order to finance their economic activities (Meyer and Nagarajan 2000).

Meyer and Nagarajan (2000) assert that demand for credit depends on household attributes and the village characteristics in which households live. As the interest rate is fixed, there is some rudimentary credit rationing, in which lenders screen the applications and decide to whom to offer loans and how much to offer. Some applicants receive loans, others are rejected, and yet others receive smaller loans than they applied for. Hence, in this strand of the literature, the generic model tends to pose three most important issues, namely, to: identify the determinants of the credit supply to households; specify the determinants of credit rationing; and determine the channels through which credit may contribute to household welfare.

The second strand of the theoretical literature focuses on the unconventional methods that microfinance institutions use to improve borrowers’ payback behaviour (Morduch, 1999). In particular, the literature deals with the implications of group lending practices with jointly liable borrowers. A joint liability contract specifies that the entire group is liable for loans that are given to individual group members. A well-known example is the Grameen Bank’s group lending program.

It has been emphasised that group lending with joint liability may lead to peer-monitoring or peer-pressure among group members which reduces problems of moral hazard and enforcement. This may be because a high joint liability component in the debt contract provides incentives to borrowers to choose a safe investment project. In addition, some recent theoretical papers have noted that joint liability lending induces group members to self-select each other (Ghatak, 2000).
2.3 Empirical Literature

2.3.1 General Review on Microfinance and MSEs Performance

Kiriti, ng’ang’a and wangulachi (2008) in their study on determinants of expansion of small scale enterprises in Kenya found out that the notable sources of credit for the borrowers were the micro finance, banks and family/relatives and informal and informal money lenders. Their study indicated that micro finances were increasingly becoming a source of small scale business credit. This was attributed by the fact that micro finance institutions conditions for credit were minimal; members, shares, households assets. Generally, the constraints to adequate credit remain high interest rates, lack of information on lending institutions, lending ceiling and lack of collateral. The study revealed that proper utilization of loans provided new funds which enabled the business owner to obtain more goods hence realizing more profits which made more funds available for investment in the business.

Micro finance institutions have played a significant role in the rural areas in Kenya especially in providing credit to small and micro enterprises. However, there is need for a greater focus on the production and manufacturing enterprises. Financing the production and manufacturing enterprises especially in agriculture would benefit more rural families for there is greater potential for employment creation (MFMI 2008).

Woller (2004), points out that Microfinance Institutions provide important sources of financing for MSEs, but their outreach is typically more limited than that of traders who frequently provide working capital in cash or kind, especially in rural areas. Because of limited access to capital, entrepreneurs across the world typically start firms primarily through their own savings. For example, a study of over 14,000 microenterprises in Mexico found that owners mostly used their own resources and savings (61%) or those of their family and friends (14%) to launch their firms (Paga’n, & Paxton, 2005).
Macharia (2003) carried out a study on performance of MSEs in Kitale town that had received K-REP loan. The study used primary data collected using questionnaires. Results showed that input and output prices, technical skills of operators of MSEs, type of MSEs, market size and loan volume affect performance of MSEs. Supporting the same view, Copestake et al. (2001) find that borrowers who were able to obtain two loans experienced high growth in profits and household income but borrowers who never qualified for the second loan were actually worse off due to MFI collection mechanisms.

Wydick (1999) found that upward class structure mobility increases significantly with access to credit. Using the same Guatemala data set in a subsequent study (2002), Wydick also finds that rapid gains in job creation after initial credit access were followed by prolonged periods of stagnant job creation. Dunn (2001) finds that microfinance program clients' enterprises performed better than non-client enterprises in terms of profits, fixed assets, and employment. Finally, Anderson et al. (2002) analyzed 147 MFIs and finds that microfinance participation increased environmental awareness and common pool resource stewardship.

2.3.2 Micro and Small Enterprises and Credit accessibility in Kenya

Bank credit is among the most useful sources of finance for business in Kenya (Government of Kenya 2005). Bank credit refers to loans and overdrafts extended to enterprises by formal banking institutions. However, a report by National Development Plan (1997-2001) on MSEs development in Kenya found that most MSEs are not organized and hence do not attract financing from the MFIs. Some hardly keep the books of accounts and cannot determine the profitability of the business. A case study of Micro and Small Enterprise Training and Technology Project (MSETTP, 1997) showed that 70% of MSEs lacked business planning skills and some businesses could not get credit purely because they are not able to write a bankable proposal.

Ondiege (1996) demonstrated that access to credit is associated with improved performance of MSEs in Kenya. Moreover, Lundvall et al. (1998) show that manufacturing enterprises in Kenya that have limited access to credit also tend to be
less productive and cannot always move to points of best practice. This indicates that since the MSEs sector does not have adequate access to credit, its potential role in transforming the country is unlikely to be realized.

Steveson and Stonge (2005) contend that accessibility to initial capital, even when available, is also a major hurdle for women entrepreneurs. Microfinance institutions (MFIs) and commercial banks choose where they locate, thus excluding entrepreneurs in remote regions, leading to regional disparities. Credit conditions when forming a group, paying membership fees, group registration fees and joining saving plans, result in delays in accessing initial capital, thereby worsening the women's household financial burden.

2.4 Microfinance Factors Affecting MSEs Performance

2.4.1 Training and MSEs Performance

Armstrong (2001) defines training as the formal and systematic modification of behavior through learning which occurs as a result of education, instruction, development and planned experience. He further asserts that the fundamental aim of training is to help the enterprise achieve its purpose by adding value to its key resource- the people it employs. Training means investing in people to enable them perform better and it empowers them to make use of their best abilities.

The importance of training as one tool for MSEs performance and growth has been recognized worldwide. Many studies have revealed that training contributes significantly in the improvement of performance and growth of enterprises. For example, Edgcomb (2002) established that training has significant impact on participant characteristics and final participant outcomes. Training adds to the skills of MSEs owners, change their behavior on how they perceive and conduct business activities and in turn enhance their ability to perform better.

Research on the impact of BDS on MSEs is limited, and where impact has been assessed, the results appear inconclusive. Matlay (2004) observes that while small business owner-managers are aware of the existence of training opportunities...
especially those sponsored by governments, their usage of such services has remained low. More importantly, however, none of these initiatives appears to have made a significant impact upon the skill levels and or the competitiveness of smaller firms. This may be due to a mismatch between small business training needs and the services offered by trainers. Nevertheless the necessity for enterprise support initiatives cannot be questioned.

With the right skills; the MSEs owners can gain important edges even under stiff competitive environment. Through training, the enterprise owners can acquire networks, transfer technology, develop commercial entities and acquire new and better management techniques. This because business training is mainly geared towards building entrepreneurial skills and traits of the recipients in orders to better their business practices (Hassan, 2009).

Dean and Martin (2006) found strong benefits of MSEs entrepreneurs training for both the client and the microfinance institution. The client shows improved business processes and knowledge and increased sales. The microfinance institution benefits from increased retention and repayment.

Heino and Pagan (2001) assert that limited access to soft reproductive resources particularly basic management and financial literacy can restrict the capacity of business owners to participate effectively in business activities. Microfinance programmes were introduced as a means to provide credit which is an important source of the need capital. However as argued above, provision of credit alone without business skills, it is not possible for enterprises to perform at an optimal level. Therefore, one of the objectives of this study will be to establish the effects of training MSEs owners on business performance.

Beck et al (2009) report a positive relationship between training, competence, and performance among SMEs involved in e-business activities. Their study used a sample of 339 SMEs drawn from three European countries, Norway, Finland and
Spain. Based on their empirical analyses, the authors claim that training explains variances in e-business competences and performance in terms of efficiency, complementarities, lock-in and novelty.

Atieno (2001) asserts that access to affordable training is a barrier to entrepreneurial activity. The concept of microfinance, and especially when accompanied by the development of business skills, has evolved as an institutionalised response to this challenge in promoting the performance of micro and small enterprises in Kenya.

2.4.2 Microsaving and Microinsurance Products and MSEs Performance

MFIs provide similar products and services to their customers as formal sector financial institutions. The scale and method of delivery differ, but the fundamental services of savings, loans, and insurance are the same. Notwithstanding, to date most efforts to formalize microfinance have focused on enterprise lending (loans for enterprise formation and development) which remain by far today the dominant product offered by MFIs. This, however, has slowly begun to change. Increasingly today MFIs have begun to offer additional products, such as savings, consumption or emergency loans, insurance, and business education (Woller 2004).

Nourse (2001) reviews the context and rise of microfinance products and argues there is a need for savings and insurance services for the poor and not just credit products. He goes on to argue that MFIs need to provide tailored lending services for the poor instead of rigid loan products. Supporting this latter assertion of Nourse (2001), Eyiah (2001) developed a model of small construction management contractors and MFIs in developing countries that provides a tailored lending structure for microenterprise contractors. Similarly, Woller (2002), Cohen (2002), and Dunn (2002) argue that MFIs need to be more client-focused, including offering a mix of financial products tailored to the varied needs and wants of poor consumers.

Yaron (1994) notes that savings is critical component of MFI success by serving as collateral on loans and introducing and enhancing financial discipline among inexperienced, first-time, small-scale borrowers. Microcredit is explicitly costly, with effective annual interest rates of up to 130%; while savings is relatively cheap,
leading Yaron speculate that savings facilities can serve a greater number of clients than lending services. They further claim success in mobilizing savings as the optimal, and in some cases unique, path toward MFI financial self-sustainability. Well-established empirical evidence supports this perspective (Hulme and Mosley, 1998; and Morduch, 2000).

Micro pensions, combining microinsurance and microsavings to produce retirement income, are an emerging area of microfinance. The largest initiative is in India, where approximately 85 per cent of the workforce is in the informal sector and a similar percentage of workers do not qualify for a pension. Over the past four years, more than 200,000 workers have enrolled in a micropension scheme developed by Invest India Micro Pension Services, which reduces costs by leveraging technology and existing infrastructure. The programme is being implemented with a range of partners, including state governments, cooperatives, non-governmental organizations and international organizations, and adapted into various models (Santi Rozario 2007).

Ndirangu (2001) points out that loans from Kenyan microfinance institutions tend to be limited in amount, have no grace period, are short term in design and carry very high interest rates. Consequently, most entrepreneurs are likely to have multiple short-term loans to cater for both business and social needs. Loans to MSE entrepreneurs only satisfy a fraction of their financial needs. When they are exposed to personal risks resulting in losses beyond their means, competing needs for cash limit the growth of their enterprises. They also tend to contribute to the collapse of such businesses. This calls for a need to restructure the financial products available to entrepreneurs to include long-term micro-insurance products.

Makokha (2006) established in her study that women entrepreneurs have financial social demands that compete with business capital, leading to a diversion of capital away from business needs. Some of these factors include housing space, health, old age and divorce. Therefore, the study concluded that there was need to develop long-term financial products such as micro-insurance. While microfinance provides working capital and disposable incomes to women in MSEs, microinsurance products would ensure that the assets of these entrepreneurs are protected if their income is
diverted from their businesses. The MFIs would also benefit as their clients' sustainability would contribute to their own. Some specific products that need to be rolled out freeing capital and benefiting women entrepreneurs include: loan insurance; life insurance; pension; house insurance; health insurance; asset insurance; and, long-term housing loans or mortgages.

According to ILO (2007), Loans offered to MSEs by MFIs propose a variety of short-term credits aimed at their business and household needs. For instance, both K-REP and KWFT, which are the largest MFIs offering credit, in addition to business loans, also offer consumer, medical and education loans to cater for related needs.

2.4.3 Loan Lending Methods and MSEs Performance

Hartungi (2007) has argued that microfinance has been an innovation and design of product which assist to provide new financial service to the poorest people. For example, group based lending; collateral free lending system and group monitoring system etc. are the innovation and designs of Grameen Bank. Grameen Bank offers new information technology, a technological innovation, which has extended the effectiveness and feature of micro-financial service. It has adopted Automated Tellers Machines (ATMs) and computerized administering system which make easy the transaction such as loan payment, money transfer, saving account controlling etc and help to obtain information quickly.

Hassan (2002) depicted that an innovation of Grameen Bank which is group-based lending has contributed a key success of micro-finance in Bangladesh. Grameen Bank introduced an exclusive group lending technique through offering the basic and flexible loan, hence increased flexibility for its borrowers and eased peer pressure among the groups. (Busse & Victoria Noelle, 2008). It also integrated the benefits of group lending, thereby having an attempt to minimize the restrictions and disadvantages of micro-finance. (Hulme and Moore, 2006). Likewise, Bancsol replicated the Grameen group lending system. As a consequence, they depicted that group lending could be one the success factors of micro-finance which permitted Grameen Bank to implement the management of the particular tasks such as screening
and group monitoring for loan repayment from borrowers, thereby assisting the Grameen Bank to enable for allocating the micro-credit.

In group lending programmes, members are made jointly liable for the loans given. The joint liability plus the threat of losing access to future loans motivates members to perform functions of screening loan applicants, monitoring borrowers and enforcing repayment. Investigations of the effect of intragroup pooling of risky assets show that groups exploit scope and scale economies of risk by pooling risks and entering into informal insurance contracts. This confirms the role of social cohesion in group repayment (Zeller, 1998).

Besley and Coate (1995) show that group-levied social sanctions, including peer pressure, loss of social prestige, and social isolation, can improve rates of loan repayment. Joint liability transfers certain fixed costs of small-scale lending, including screening, contract, monitoring, and enforcement, from the bank to the group, rendering financially viable the administration of small loans in rural areas to people traditionally regarded as high-risk. Though joint liability imposes some non-trivial costs upon participants, including frequent group meetings and limited access to individual credit, members of groups continue to seek loans. Empirical evidence generally supports the superiority of group lending repayment rates over repayment rates of loans issued to individuals.

According to MFMI (2008) the group based lending model was found to be very successful and there was lower default rate in comparison to the individual lending. Micro finance institutions could therefore employ this model when lending to rural micro and small scale enterprises. However, it was noted that the group model places constraints on individual efforts and the enterprises with greater capability might not achieve their full potential due to group members. Micro finance institutions should therefore apply both group and individual approach to avoid situations where some group members feel unfairly treated. This however requires a good understanding of the group. The micro finance institutions’ extension officers should forge a good relationship with group members so as to understand individual group members’ needs as well as their capabilities.
It is argued that the optimal outcome is one in which all borrowers with the same probability of success match together (homogeneous matching). It has also been argued that the optimality of homogeneous matching only holds in a frictionless world. However, the real world is characterised by frictions due to imperfect information, the unavailability of partners with the same risk characteristics, the inability to enforce contracts and the inability to fully screen and monitor group members (Green et al., 2005).

In recent years, many institutions have made the shift to individual liability while still keeping the “group” intact for administrative purposes. For example, BancoSol in Bolivia has converted large shares of their group liability portfolio into individual liability lending, and Grameen Bank in Bangladesh has recently relaxed the group liability clause in the Grameen II program. This approach appears to preserve many of the benefits of group lending without the unintended costs of group liability. Organizing borrowers in groups lowers transaction costs by simplifying loan disbursal and collection logistics, and may maintain some of the monitoring and enforcement effect due to the shame of defaulting in front of an audience of peers. But until recently, there has been little quantitative evidence to support lenders who take this approach (Karlan 2009).

2.4.4 Cost of Credit and MSEs Performance

Whereas many MFIs emerged to provide initial and working capital, relevance and cost-effectiveness is often inappropriate in satisfying the particular needs of potential and operating women entrepreneurs (Government of Kenya, 1999). Where accessible, the cost of credit was found to be expensive for most MSEs; for instance, the interest rates charged by some MFIs is as high as 54 per cent per annum. This coupled with a short repayment period becomes a major constraint, resulting in forcing the entrepreneur to work almost round the clock to service the loans. The exorbitantly high cost of initial capital tends to make the enterprise almost uneconomical to operate as a business. This is common to most formal sources of credit as well as MFIs.
Malkin (2008) notes that since the size of the average loan given out by microfinance banks is small, even the most pro-poor microfinance banks must charge relatively high interest rates in order to recoup operating expenses, and such rates may exceed the returns to capital for many entrepreneurs. From this, it is not clear that it will ever be probable for banks to dramatically increase their lending to the poorest of the poor, which means that access to such credit may never come.

Though commercial banks and Microfinance Institutions (MFIs) have vast financial resources, their impact is yet to be felt among the MSEs, and particularly by women entrepreneurs, most of whom have no collateral. Consequently, most banks have created special facilities to support MSEs as a result of Government encouragement and their own need to expand. However, many entrepreneurs and, in particular women, tend to steer clear because of lack of information, and conditions such as high transaction costs and interest rates averaging above 35 per cent per annum. Commercial banks, which have microfinance programmes, include Cooperative Bank of Kenya, Kenya Commercial Bank, Barclays Bank, Standard Chartered Bank, Equity Bank, National Bank of Kenya and K REP Bank (ILO 2007).

2.5 Summary of Literature and Research Gaps

Microfinance programs and institutions are increasingly important in development strategies. They have become an important component of strategies to reduce poverty or promote micro and small enterprise development. However, knowledge about the achievements of such initiatives remains only partial and contested. At one extreme are studies arguing that microfinance has very beneficial economic and social impacts. At the other are writers who caution against such optimism and point to the negative impacts that microfinance can have. Given this state of affairs the assessment of microfinance programs remains an important field for researchers, policymakers and development practitioners (Humle 2005).

The proponents of Microfinance programmes believe that access to small loans creates a virtuous cycle of investment and increased income that breaks the vicious cycle of poverty in which many poor people are trapped. It is argued that the infusion of credit creates opportunities for self-employment for poor borrowers and that this in
turn augments their income and leads to increased consumption and investment. Continued access to credit and the process of increased investment increases income yet further. This theory suggests that as this cycle is continually repeated with successive loans the "poor" borrower will gradually climb out of poverty (Khan 2008).

Many commercial financial intermediaries, such as banks are reluctant to advance relatively small loans to large numbers of poor people. This reticence is based on a host of factors of varying importance. Poor people are often unable to provide the types of traditional collateral required by banks such as deeds for property; they may be illiterate and unable to complete the application forms; the distance to the nearest bank may be too far for them to travel both to complete the application forms as well as to make regular repayments; the size of loans required by poor people and the costs incurred in analysing and processing such loan applications may make them economically unattractive to banks; or poor people may be unemployed or without a regular or verifiable sources of income. Therefore, and as a consequence of both the formal (banks) and informal (moneylenders) private commercial sector being unable to meet the micro financial demands of poor people, other microfinance providers such as NGOs, more often stimulated by social rather than commercial gain, are attracted to providing small loans and savings services.

Although many MSEs have limited access to capital, it is often unclear whether credit represents a binding constraint on firm performance. Few empirical studies have explicitly tested the positive link between microfinance and MSE performance. The findings from one econometric study, based on a random sample of 225 MSEs producing garments in Nairobi, Kenya, suggests that further research is needed (Akoten, Sawada, & Otsuka, 2006).

Given the two lines of thought, one supporting the view that microfinance has contributed positively towards MSEs performance and development and other doubting the same, there is a need for further study in this area.
2.6 Conceptual Framework

Independent variables

**Training Microfinance Clients**
- Management Skills
- Proper Loan Utilisation

**Cost of Credit**
- Loan Application Fee
- Interest Charges

**Saving and Insurance Products**
- Regular Cash Deposit
- Regular Insurance Installment

**Loan Lending Methods**
- Individual Lending Method
- Group Lending Method

Dependent variable

**Performance of Micro and Small Enterprises (MSEs).** Indicators include:
- Profit Growth
- Increase In Assets
- Level of Stock
- Sales Turnover
- Number Of Employees

**Moderating Variables**

Source: Author 2011
The underlying concept of this study was to investigate microfinance factors affecting performance of MSEs funded by microfinance institutions in Kenya. Programs designed by MFIs to boost credit and finance to the MSE sector have been formulated in the absence of reliable information such as data on magnitude of the MSEs sector, characteristics of MSE operators and factors influencing the growth and dynamics of the sector. The situation translates into high credit transaction costs, for collecting and verifying available information mainly on the credit worthiness of MSE borrowers. Furthermore, the lending methodologies have also put off potential customers (sessional paper 2 2005). Micro Finance Institutions also train those who qualify their loans on how to utilize the funds obtained in business growth and expansion.

This research considered microfinance factors affecting the MSEs performance as the independent variables. These include; training microfinance clients, cost of credit, microfinance products, and lending methods. Microfinance institutions train their clients as a prerequisite for loan administration. The purpose is to equip entrepreneurs with knowledge and skills for better utilization of funds in the enterprise. The cost of credit includes loan application fee and interest changed on the loan. Credit alone is insufficient to cater for all financial needs of MSEs owners. Most Microfinance institutions offer saving and insurance products to give MSEs financial security. Microfinance uses both individual and group lending methods to administer loans to clients. Each method has its own merits and limitations as highlighted in the literature review.

Business performance was the dependent variable whose indicators are; level of assets capital base, profit growth, sales turn over, increment in stock and number of employees. Both the independent and the dependent variables are influenced by moderating variables which include; government policy on MSEs, economic environment, political environment and infrastructure.
CHAPTER THREE

RESEARCH METHODOLOGY

3.0 Introduction

This section outlines the methodology that was used in the study. It’s divided into five parts which are research design, population of the study and sampling instruments, data collection and data analysis.

3.1 Research Design

The research adopted a descriptive research survey to collect primary data to answer questions concerning the status of the issues under investigations. A descriptive survey design allows researchers to gather information, summarize, present and interpret it for the purpose of clarification. The method was appropriate since it allows for collection of qualitative information such as those aimed at measuring attitudes, opinions or habits which this study was aimed at (Mugenda and Mugenda, 2003). Various beneficiaries of micro finance in Murang’a Town were identified and a sample was interviewed to establish the Microfinance factors affecting performance of MSEs.

3.2 Population of Study

The population for the study was the 300 MSEs in Murang’a Town which are registered at the Municipal council of Murang’a. These businesses in Murang’a Town include open air market operators, retail shop owners, metal workers, carpenters, hardware businesses, second hand cloth sellers etc.

3.3 Location of the Study

The location of the study was Murang’a Town in Murang’a County. This town has many micro and small enterprises and a substantive number of MFIS which include Faulu Kenya, Kenya Women Finance Trust (KWFT), Ecumenical Loans Fund (ECLOF) among others. Therefore, data was available as acknowledged by the many entrepreneurial activities in the area and the presence of these microfinance institutions.
3.4 Sampling Strategy

Stratified random sampling was used. The goal was to achieve desired representation from various sub groups in the population. The population of small and micro enterprises was subdivided on criterion of the different sub sectors for example hotel and restaurants, carpenters and retail shops and so on. The intended sample size was 60 respondents. This sample was well within the 10% minimum sample for descriptive analysis as proposed by Gay (1976) and the 60% maximum as proposed by Cohen and Marion (1994) for statistical analysis. In this case the sample selected was 20% of the population which according to Kerlinger (1986) has a high degree of accuracy and precision of estimate. The sample was deemed to be representative enough of the whole population and therefore valid and genuine generalisations could be made. According to Mugenda and Mugenda (2003) the sample should be small enough to be economical in terms of expenses on time, money and data analysis and ensured representation of all in the population proportionately.
Table 3.1 Sample Size

<table>
<thead>
<tr>
<th>Type of Business</th>
<th>Population Frequency</th>
<th>Sample Population (20%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retail Trading shops</td>
<td>50</td>
<td>10</td>
</tr>
<tr>
<td>Kiosk traders</td>
<td>25</td>
<td>5</td>
</tr>
<tr>
<td>Hotels and restaurants</td>
<td>35</td>
<td>7</td>
</tr>
<tr>
<td>Textiles, Boutiques and Tailoring</td>
<td>45</td>
<td>9</td>
</tr>
<tr>
<td>Wood and wood products</td>
<td>10</td>
<td>2</td>
</tr>
<tr>
<td>Salons</td>
<td>30</td>
<td>6</td>
</tr>
<tr>
<td>Welding and metal fabricators</td>
<td>10</td>
<td>2</td>
</tr>
<tr>
<td>Communication and ICT</td>
<td>30</td>
<td>6</td>
</tr>
<tr>
<td>Informal traders eg. Open air market</td>
<td>50</td>
<td>10</td>
</tr>
<tr>
<td>traders and hawkers</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Agrochemicals</td>
<td>15</td>
<td>3</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>300</strong></td>
<td><strong>60</strong></td>
</tr>
</tbody>
</table>

Source: Murang’
a Municipal Council (Business Registration data base, 2011)

3.5 Data Collection

The study employed both primary and secondary data. Primary data was derived through administration of questionnaires. Secondary data was acquired from existing literature. Questions included open ended and close ended. The questionnaires were self administered to the sampled respondents. Open ended questions were used to solicit qualitative data and suggestions while close ended questions sought to obtain quantitative data for statistical analysis. Questions asked focused on the MSEs and the micro finance institutions that finance them. The questionnaires were dropped and
picked later. Where the respondents were illiterate, questionnaires were administered orally.

3.6 Data Analysis

Data analysis for this study was done using Statistical Package for Social Science Software (SPSS). This is because this program helps in organising the data and the presentation of data through charts and graphs is made easy (Mugenda and Mugenda, 2003). Descriptive statistics such as frequency and percentages tables, pie charts and bar graphs were used to allow easy interpretation, conclusions of the findings and finally recommendations of the study.

3.7 Study Outcome

This study sought to investigate microfinance factors affecting performance of MSEs in Kenya with a special reference to those located in Murang’ar town. Despite the presence of microfinance institutions and banks which offer microfinance products in Murang’ar, performance and growth of MSEs has been slow. From the data analysis this study established the contribution of Microfinance institutions towards MSEs performance. Challenges that MSEs face in seeking financial services from microfinance institutions were established.
CHAPTER FOUR

DATA ANALYSIS AND PRESENTATION

4.1 Introduction

This chapter gives a systematic analysis of data collected during the research and a presentation of the analyzed data in the form of frequencies, tables, pie charts, and percentages. The general objective of this research was to investigate microfinance factors affecting the performance of Micro and small businesses in Murang’a town.

4.2 Analysis of Response Rate and Background Information

This section deals with the analysis of response rate and background information on the characteristics of the Micro and Small Enterprises in Murang’a Town. The analyzed data is presented in the table below.

4.1: Response rate of different types of business

<table>
<thead>
<tr>
<th>Type of Business</th>
<th>Sample Population</th>
<th>Frequency</th>
<th>Response rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retail Trading Shop</td>
<td>10</td>
<td>10</td>
<td>100%</td>
</tr>
<tr>
<td>Kiosk Traders</td>
<td>5</td>
<td>5</td>
<td>100%</td>
</tr>
<tr>
<td>Hotels and Restaurants</td>
<td>7</td>
<td>7</td>
<td>100%</td>
</tr>
<tr>
<td>Textiles, Boutiques &amp; Tail</td>
<td>9</td>
<td>7</td>
<td>77.8%</td>
</tr>
<tr>
<td>Wood and wood Products</td>
<td>2</td>
<td>2</td>
<td>100%</td>
</tr>
<tr>
<td>Salons</td>
<td>6</td>
<td>5</td>
<td>83.3%</td>
</tr>
<tr>
<td>Welding and Metal Fabricators</td>
<td>2</td>
<td>2</td>
<td>100%</td>
</tr>
<tr>
<td>Communication &amp; I.C.T</td>
<td>6</td>
<td>6</td>
<td>100%</td>
</tr>
<tr>
<td>Open Air Market Traders</td>
<td>10</td>
<td>7</td>
<td>70%</td>
</tr>
<tr>
<td>Agro-chemicals</td>
<td>3</td>
<td>2</td>
<td>66.7%</td>
</tr>
<tr>
<td>Total</td>
<td>60</td>
<td>53</td>
<td>88.3%</td>
</tr>
</tbody>
</table>

Source: (Survey 2011)
Data analysis indicated that from the sampled businesses, those in the retail trading, kiosk, hotels and restaurants, wood and wood product, welding and metal work and communication showed a 100% response rate to the questionnaire issued. Those in textile, boutique and tailoring, those in salon categories, in open air market market-traders and lastly in agro-chemicals responded at 77.8%, 83.3%, 70% and 66.7% respectively. The overall response rate by businesses in all the strata was 88.3%.

Analysis of gender of the respondents indicated that the number of female entrepreneurs in Murang’a Town is higher than that of their male counterparts at 56.6% and 43.4% respectively.

![Figure 4.1: Gender of the respondents](image)

Source (Survey 2011)

### 4.2.1 Business Characteristics.

The first section of the questionnaire sought to establish the businesses characteristics of Micro and Small Enterprises in Murang’a Town. The main features of the sampled businesses are presented in the table in the next page.
Table 4.2: Business Characteristics.

<table>
<thead>
<tr>
<th>BUSINESS DETAILS</th>
<th>FREQUENCY</th>
<th>Percentage of sample</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Type of business ownership</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>a) sole</td>
<td>42</td>
<td>79.3%</td>
</tr>
<tr>
<td>b) partnership</td>
<td>10</td>
<td>18.9%</td>
</tr>
<tr>
<td>c) others</td>
<td>1</td>
<td>1.9%</td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td><strong>53</strong></td>
<td><strong>100.00%</strong></td>
</tr>
<tr>
<td><strong>Number of employees</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>a) 0-9</td>
<td>52</td>
<td>98.1%</td>
</tr>
<tr>
<td>b) 9-20</td>
<td>0</td>
<td>0%</td>
</tr>
<tr>
<td>c) Above 20</td>
<td>1</td>
<td>1.9%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>53</strong></td>
<td><strong>100.00%</strong></td>
</tr>
<tr>
<td><strong>Period of business operation</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less than 1 year</td>
<td>8</td>
<td>15.1%</td>
</tr>
<tr>
<td>1-5 years</td>
<td>26</td>
<td>49.1%</td>
</tr>
<tr>
<td>6-9 years</td>
<td>7</td>
<td>13.2%</td>
</tr>
<tr>
<td>10-15 years</td>
<td>6</td>
<td>11.3%</td>
</tr>
<tr>
<td>Above 15 years</td>
<td>6</td>
<td>11.3%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>53</strong></td>
<td><strong>100.00%</strong></td>
</tr>
<tr>
<td><strong>Level of education</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>a) no formal education</td>
<td>1</td>
<td>1.9%</td>
</tr>
<tr>
<td>b) primary</td>
<td>8</td>
<td>15.1%</td>
</tr>
<tr>
<td>c) secondary</td>
<td>22</td>
<td>41.5%</td>
</tr>
<tr>
<td>d) college</td>
<td>22</td>
<td>41.5%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>53</strong></td>
<td><strong>100.00%</strong></td>
</tr>
<tr>
<td><strong>Business Registration</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>a) Registered business</td>
<td>47</td>
<td>87.8%</td>
</tr>
<tr>
<td>b) Non-registered business</td>
<td>7</td>
<td>13.2%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>53</strong></td>
<td><strong>100.00%</strong></td>
</tr>
</tbody>
</table>

Source (Survey 2011)
Data analysis on business characteristic helped to bring out the descriptive picture of small business in Murang’á town. Out of the 53 sampled business 79.3% of these are under sole ownership 18.9% under partnership and only 1.89% fell under others category and in this case only one business which was under franchise.

Concerning the number of employees, 98.1% of the MSEs in Murang’á Town employed between 0 and 9 employees, non-employed between 10-20 employees and only 1.9% had employed over 20 employees.

Analysis of the length of time the MSEs in Murang’á town have been in operation indicated that majority of MSEs; in this case 49.1% had been in operation between a period of 1 and 5 years 15.1% of MSEs had operated for a period of 6 to 9 years. 11.3% of MSEs had been operation for a period of 10 to 15 years and lastly 11.3% of MSEs had been in operation for over 15 years.

With regard to the level of Education of the entrepreneurs, those educated up to secondary and college level were equal in number at 41.5%. Those educated up to primary level at 15.1% and only one entrepreneur or 1.9% had no formal education. The fact that 83.0% of the entrepreneurs were educated either up to secondary or college level is in agreement with the employment generation. Daniels (1994) asserts that the MSEs sector develops in response to the growth in unemployment, functioning as a place of last resort for people who are unable to find employment in the formal sector.

Finally, on business characteristics, concerning analysis of the aspect of business registration, this research established that majority of MSEs in Murang’á town are registered at 87.8% only a meager figure of 13.2% of MSEs are not registered. These as the research found out are MSEs which mostly operated in the open air market.
4.3 Business Training by Microfinance Institutions

This research established that out of the 53 respondents, 75.47% had received credit while 24.53% had not received credit from microfinance institutions. Out of the 40 respondents whose business had received credit from MFIs, 62.50% had received training while 37.5% had not received training.

Figure 4.2: Respondent Benefits on Microfinance Credit

Source (Survey 2011)

Figure 4.3: Training as a Prerequisite for Loan Award

Source (Survey 2011)
4.3.1 Effects of Business Training on Business Performance

The respondents’ response on the effect of business training on their business performance is presented in the table below.

Table 4.3: Effect of Training on Business Performance

<table>
<thead>
<tr>
<th>Level of effect of Training</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>No effect</td>
<td>0</td>
<td>0%</td>
</tr>
<tr>
<td>To a low extent</td>
<td>3</td>
<td>10%</td>
</tr>
<tr>
<td>To a great extent</td>
<td>18</td>
<td>60%</td>
</tr>
<tr>
<td>To a very great extent</td>
<td>9</td>
<td>30%</td>
</tr>
<tr>
<td>Total</td>
<td>30</td>
<td>100%</td>
</tr>
</tbody>
</table>

Source (Survey2011)

The analyzed data presented above indicate that all respondents who had received training concurred that training affects their business performance. Indeed, 90% agreed that training affects performance to a great or to a very great extent. Only a meager 10% felt that the effect was to a low extent. The contention by the entrepreneurs that training affects business performance is fully in line with the reviewed literature. Hassan (2009), points out that through training, MSEs owners can gain important edges even under stiff competitive environment. The enterprise owners can acquire network, transfer technology, develop commercial entities and acquire new and better management techniques.

Responding to how training offered help to improve the performance of the business, the respondents who had received training gave their responses as presented in the table below.
Table 4.4: Measures of How Training Improve Business Performance

<table>
<thead>
<tr>
<th>How Training Helped Improve Performance</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Acquired Business management skills</td>
<td>21</td>
<td>23.6%</td>
</tr>
<tr>
<td>Proper Loan Utilization</td>
<td>22</td>
<td>24.7%</td>
</tr>
<tr>
<td>Marketing of Business Products</td>
<td>8</td>
<td>9.0%</td>
</tr>
<tr>
<td>Keeping Business Records</td>
<td>8</td>
<td>9.0%</td>
</tr>
<tr>
<td>Total</td>
<td>59</td>
<td>66.3%</td>
</tr>
<tr>
<td>Missing System</td>
<td>30</td>
<td>33.7%</td>
</tr>
<tr>
<td>Total</td>
<td>89</td>
<td>100%</td>
</tr>
</tbody>
</table>

Source (survey 2011)

4.4 Microfinance Products and Services

Analysis of microfinance products and services and business performance is represented in the bar graph below.

Figure 4.4: Microfinance Products and Services

Source (survey 2011)

Data analysis indicates that all the respondents have benefited from at least one of the microfinance products offered by MFIs. Indeed 34.7% of the sampled MSEs had benefited from micro credit. Concerning micro insurance, 2.1% had benefited from
micro insurance health product, 7.4% had benefited from micro insurance business assets products with regard to micro saving product, majority of the respondents in this case 55.8% had benefited from micro saving product.

The fact that all the MSEs sampled had benefited from various microfinance products and services is in line with literature reviewed for instance, Woller (2004) noted that microfinance institutions have of recent moved from just offering micro credit and have began to offer additional products, such as savings, and insurance.

4.4.1 Microfinance Products and Fee Charges

Responding on whether there was any fee charges incurred in order to receive microfinance products, 90.57% concurred that they were charged a fee in order to receive microfinance products. Only 9.43% were not charged any in order to receive the microproducts they had applied for.

![Figure 4.5: Microfinance Products and Fee charges](image)

Concerning satisfaction by microfinance product received, majority of the respondents at 62.5% indicated that they were satisfied and only 37.5% of the respondents were not satisfied with the microfinance product.
With regard to dissatisfaction, the respondents who felt that they were not satisfied, gave following reasons represented inform of a bar graph as shown below.

Figure 4.7: Reasons for Dissatisfaction with Products and Services

Source (survey 2011)
Analysis of the bar graph information indicates that majority of the respondents at 95% pointed out that high processing fee as the major reason for dissatisfaction. 60% indicated long and tedious application as the reason and only 15% pointed out bank account ledger fee as the reason for dissatisfaction.

4.4.2 The Effect of Products and Services on Business Performance

The analyzed response from the respondents as to the effect of products and services on business performance is presented in the table below.

Table 4.5: The effect of products and services on business performance.

<table>
<thead>
<tr>
<th>Effects of Products and Services on Business Performance</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid No effects</td>
<td>3</td>
<td>5.6%</td>
</tr>
<tr>
<td>To a low extent</td>
<td>12</td>
<td>22.6%</td>
</tr>
<tr>
<td>To a greater extent</td>
<td>18</td>
<td>34%</td>
</tr>
<tr>
<td>To a very great extent</td>
<td>11</td>
<td>11.3%</td>
</tr>
<tr>
<td>Missing system</td>
<td>9</td>
<td>20.8%</td>
</tr>
<tr>
<td>Total</td>
<td>53</td>
<td>100.0%</td>
</tr>
</tbody>
</table>

Source (survey 2011)

Majority of the respondents agreed that the products and services offered by microfinance institution affect performance of their businesses to some extent. A combined 64.8% agreed that products and services affect business performance either to a great or to a very great extent. This is in line with the reviewed literature. For instance, Makokha (2006) established that women entrepreneurs have financial social demands that compete with capital, leading to diversion of capital away from the business. The study concluded that there was a need to develop long term financial products such as micro-insurance and micro saving. This would ensure that the assets of these entrepreneurs are protected if their income is diverted from their business.
Ndirangu (2001) also pointed out that loans MSEs entrepreneurs only satisfy a fraction of their financial needs to restrict their financial needs and therefore there was a need to restrict the financial products available to entrepreneurs to include long-term micro insurance products.

Responding to how Microfinance Institutions can improve products and services, respondents gave varying suggestions. Majority of the respondents at 30.2% wanted MFIs to lower interest rates on loans. A substantive number of the respondents were of the opinion that MFIs should increase interest rates on deposits to encourage entrepreneurs to save. The other suggestions were within a range of 19% and 5.7% as shown in the table below.

Table 4.6: Suggestions on Improvement of Products and Services

<table>
<thead>
<tr>
<th>Respondent Suggestions</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Marketing product in rural areas</td>
<td>1</td>
<td>1.9%</td>
</tr>
<tr>
<td>Increase loan payment time</td>
<td>1</td>
<td>1.9%</td>
</tr>
<tr>
<td>Increase interest rate on deposits</td>
<td>7</td>
<td>13.5%</td>
</tr>
<tr>
<td>Introduce new finance products</td>
<td>2</td>
<td>3.8%</td>
</tr>
<tr>
<td>Lower credit processing fee</td>
<td>2</td>
<td>3.8%</td>
</tr>
<tr>
<td>Lower interest rate on credit</td>
<td>16</td>
<td>30.8%</td>
</tr>
<tr>
<td>Lower withdrawal charges</td>
<td>3</td>
<td>5.8%</td>
</tr>
<tr>
<td>Offering insurance for business assets</td>
<td>2</td>
<td>3.8%</td>
</tr>
<tr>
<td>Offering training on business</td>
<td>2</td>
<td>3.8%</td>
</tr>
<tr>
<td>Remove collateral security conditions</td>
<td>2</td>
<td>3.8%</td>
</tr>
<tr>
<td>Shorten loan processing period</td>
<td>3</td>
<td>5.8%</td>
</tr>
<tr>
<td>Non- response</td>
<td>8</td>
<td>15.1%</td>
</tr>
<tr>
<td>Total</td>
<td>53</td>
<td>100%</td>
</tr>
</tbody>
</table>

Source (Survey 2011)
4.5 Cost of Credit and MSEs Performance

Data analysis concerning interest rate on microfinance credit is presented in the table below.

Table 4.7: Micro Credit Interest Rates

<table>
<thead>
<tr>
<th>Range</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Below 10%</td>
<td>5</td>
<td>9.4%</td>
</tr>
<tr>
<td>Between 11%- 14%</td>
<td>6</td>
<td>11.3%</td>
</tr>
<tr>
<td>Between 15% - 19%</td>
<td>31</td>
<td>58.8%</td>
</tr>
<tr>
<td>Above 20%</td>
<td>5</td>
<td>9.4%</td>
</tr>
<tr>
<td>Missing System</td>
<td>6</td>
<td>11.3%</td>
</tr>
<tr>
<td>Total</td>
<td>53</td>
<td>100%</td>
</tr>
</tbody>
</table>

Source (survey 2011)

From the analysis, 11.6% of the respondents were charged below 10% interest rate, 14% were charged an interest of 11-14%, a majority of the respondents at 48.8% were charged an interest of between 15% and 19% and lastly 11.6% of the respondents were charged an interest above 20%.

A combined 68.2% were charged an interest which was above 15%. This is a high interest rate which is in agreement with the literature reviewed. For instance, Malkin (2008) noted that since the size of the average loan given by microfinance banks is small, even the most pro-poor microfinance banks must charge relatively high interest rate in order to recoup operating expenses and such rates may exceed the returns to capital for many entrepreneurs.
Responding on to whether microfinance institutions charge high interest rates, majority of the respondents at 84.91% concurred that microfinance institutions charge high interest rates. Only 9.43% were of the opinion that they don’t charge high interest rate while 5.66% didn’t respond.

![Figure 4.8: Respondents View on Interest Rates](source (survey 2011))

4.5.1 Microfinance Credit Repayment Period

Analysis of time given by microfinance to repay the loan is presented in the table below.

<table>
<thead>
<tr>
<th>Time given</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid below 1 year</td>
<td>28</td>
<td>52.8%</td>
</tr>
<tr>
<td>Between 1-2 years</td>
<td>11</td>
<td>20.8%</td>
</tr>
<tr>
<td>above two</td>
<td>7</td>
<td>13.2%</td>
</tr>
<tr>
<td>Total</td>
<td>46</td>
<td>86.8%</td>
</tr>
<tr>
<td>Missing System</td>
<td>7</td>
<td>13.2%</td>
</tr>
<tr>
<td>Total</td>
<td>53</td>
<td>100.0%</td>
</tr>
</tbody>
</table>

Source (survey 2011)
Analysis of responses by respondents indicates that majority of them at 52.8% were given a period of below one year to repay their loan, 20.8% were given between one and two years and only 13.2% were given above two years to repay their loan. The fact that majority of the respondents were given short repayment period is in line with the literature reviewed.

The government of Kenya (1999) noted that high interest rates and short repayment period given by MFIs becomes a major constraint resulting in forcing the entrepreneur to work almost round the clock to service the loans.

4.5.2 Effect of Loan Repayment on MSEs Performance

Respondents' views on the effect of credit repayment on MSEs performance are presented in the table below.

Table 4.9: Effects of Cost of Credit on MSEs Performance

<table>
<thead>
<tr>
<th>Effect of loan payment on business performance</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td></td>
<td></td>
</tr>
<tr>
<td>No effect</td>
<td>3</td>
<td>5.7%</td>
</tr>
<tr>
<td>To a lower extent</td>
<td>15</td>
<td>28.3%</td>
</tr>
<tr>
<td>To a greater extent</td>
<td>15</td>
<td>28.3%</td>
</tr>
<tr>
<td>To a very great extent</td>
<td>7</td>
<td>13.2%</td>
</tr>
<tr>
<td>Missing system</td>
<td>13</td>
<td>24.5%</td>
</tr>
<tr>
<td>Total</td>
<td>53</td>
<td>100.0%</td>
</tr>
</tbody>
</table>

Source (survey 2011)

Analysis of data indicates that almost half of the respondents; 41.5% concurred that loan repayment affected performance of their businesses to either a great or a very great extent. 28.3% felt that loan repayment affected their business to a low extent. Only a meager 5.7% felt that loan repayment did not have an effect on their business performance. The fact that most respondents felt that loan repayment affect their business performance is in agreement with the reviewed literature. Government of
Kenya (1999), noted that high interest rates couple with a short repayment period is a major constraint, resulting in forcing the entrepreneur to work round the clock to service the loans.

4.6 Loan Lending Method and MSEs Performance

The analyzed responses concerning the loan lending method applied by the microfinance institution to give credit to MSEs, are presented in the pie chart below.

![Figure 4.9: Loan Lending Method](source: survey 2011)

Analysis of the data on loan lending method indicated that microfinance institutions used both individual and group lending methods to administer credit to their clients. 52.83% of accessed through individual lending method and 30.19% by group lending method. The outcome of the survey on this aspect is in line with the literature reviewed. For instance, Karlan (2009), noted that in recent years, many institutions have made a shift to individual lending while keeping the group intact. Others still lend to individual entrepreneurs who are not necessarily members of a business group.

On group lending Green et al (2005) asserted that group lending model was found to be very successful and there was lower default rate in comparison to individual lending. However group lending put a limit on enterprises with greater capability which might not achieve their full potential due to group members. Therefore both
individual and group approaches should be used so that customers do not feel unfairly treated.

4.6.1 Loan Defaulting in Group Lending

Responding to as whether there was loan defaulting in group lending majority of respondents 62.5% indicated that there was loan defaulting while 37.5% indicated that there was no loan defaulting in their business group.

![Pie chart showing loan defaulting in Group Lending](Figure 4.10: Loan defaulting in Group Lending)

Source (survey 2011)

On whether the group members were asked to pay the defaulted loan, a majority 56.25% were asked to pay while 37.50% were not asked to pay. The fact that majority of the respondents were asked to pay the defaulted loan by a group member is in line with the literature reviewed. For instance Zeller (1998) noted that in group lending programs, members are made jointly liable for the loan given.
Figure 4.11: Payment of Defaulted loan by Group members

Responding to whether the respondents had ever been disqualified from accessing credit from microfinance institution because of not being a member of a business group, 41.5% had not been denied access while 26.42% had been denied.

Figure 4.12: Group lending and loan accessibility

Source (Survey 2011)
4.6.2 Effect of Loan Lending Method on MSEs Performance

The analysis of responses concerning effect of loan lending method on MSEs performance is represented in the table below.

Table 4.10: Effect of loan lending method on MSEs performance

<table>
<thead>
<tr>
<th>Effect of loan lending method</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid no effect</td>
<td>3</td>
<td>5.7%</td>
</tr>
<tr>
<td>to a low extent</td>
<td>16</td>
<td>30.2%</td>
</tr>
<tr>
<td>to a greater extent</td>
<td>14</td>
<td>26.4%</td>
</tr>
<tr>
<td>to a very great extent</td>
<td>8</td>
<td>15.1%</td>
</tr>
<tr>
<td>missing system</td>
<td>12</td>
<td>22.6%</td>
</tr>
<tr>
<td>Total</td>
<td>53</td>
<td>100.0%</td>
</tr>
</tbody>
</table>

Source Survey 2011

According to the table, a combined 41.5% of the respondents concurred that performance of their business was affected by the loan lending method either to a great or a very great extent. 30.2% of the respondents were to a low extent and only a meager 5.7% felt that the lending method did not affect their MSEs performance.

The fact that 72.2% of the respondent felt that loan lending method affected their MSEs to some extent is in agreement with the literature reviewed. For instance Zeller (1998), noted that inter-group pooling of risky assets showed that groups exploit scope and scale of Economics of risk by pooling risks and entering into informal insurance contracts.
5.1 Introduction

This chapter summarizes and describes the finding of the research. This study intended to investigate the microfinance factors affecting performance on micro and small business financed by microfinance institutions in Murang'a Town. The findings revealed that the microfinance factors under investigation affect MSEs’ performance but at varying levels.

5.2 Summary

An examination on business characteristics revealed that majority of MSEs in Murang’a Town are owned by women. Most of the MSEs sampled employ between 0-9 employees. Moreover the study established that nearly all the sampled MSEs were registered and majority had operated for a period of between 1 to 5 years.

Concerning training and MSEs’ performance, the study established that majority of the MSEs which had received credit had the entrepreneurs trained as a prerequisite for loan administration. All the respondents who had received training concurred that the training affected performance of their businesses. Concerning how training improved MSEs’ performance majority of the respondents noted proper loan utilization and management skills as the main indicators of how training improved MSEs’ performance.

According to the study majority of the respondents sampled had benefited from microfinance products and services. Analysis of data revealed that more than one third of the respondents had benefited from micro credit products and more than half had benefited from micro saving products. However only a few in this case less than 10% had benefited from micro insurance products. Concerning the effect of microfinance products and services on MSEs’ performance, majority of the respondents agreed with the view that MFI products and services affect performance of their business.
With regard to cost of credit, majority of the respondents sampled felt that microfinance institution charge high interest rates. Concerning cost of credit and MSEs’ performance, the study revealed that most of the respondents felt that the cost of credit affected their MSEs performance due to a high interest rates and a short repayment period.

An examination of the loan lending methods through which MSEs’ accessed loans from microfinance institution institutions, revealed that both individual and group approaches were used by microfinance institution to administer loans to MSEs majority of the respondents had accessed loan through individual lending concerning the effect of loan lending method on business performance; majority of the respondent felt that if affected performance of their businesses to some extent.

5.3 Conclusions

Based on this study, it was concluded that performance of micro and small enterprises MSEs was affected by the factors under this study at varying degrees. Most of the respondents interviewed agreed that training affected performance of their business to a great extent. Entrepreneurs who got training acquired business management skills and were able to utilize their credit well by investing in growing their businesses.

The study also revealed that majority of the respondents felt that products and services offered by microfinance affect performance of their businesses. The study established that there was a need to more insurance products to cater for risks that most MSEs face in their day to day running of their business. Moreover nearly all the respondents felt that the cost of credit affected performance of their businesses. Therefore, it should be a point of concern micro-finance institution on how they can enhance their products and services so as to improve the performance of MSEs.

Finally, the study established that majority of the respondents felt that use of individual lending method by MFIs to administer loans to MSEs would give them more financial freedom. This freedom is in terms of loan amount and its utilization in the business.
5.4 Recommendations

Microfinance institutions should enhance provision of financial services to MSEs. The fact that a number of MSEs shy away from micro-credit scheme offered by microfinance institutions is an indication that a number entrepreneurs have a negative attitude towards them. Microfinance institutions should lower interest rates on micro-credit in order to encourage microcredit borrowing. Concerning training and MSEs’ performance, training should be geared to meet the various needs of MSEs owners. For example, very few respondents were trained on book keeping and simple accounting. Future training should lay emphasis on these aspects.

On the other hand micro and small enterprises should take advantage of the microfinance products and services. For example they should apply for new credit and micro-insurance products being offered by microfinance institutions in the recent times.

Finally, with regard to loan lending methods, a number of the respondents felt that group liability was punitive to members who were faithful in loan payment in cases where some members default their loans. Therefore, while maintaining group membership requirement, lending to individuals who are directly liable to pay loan offered should be encouraged.

5.5 Areas for Further Research

Further research should carried out in micro and small enterprises located in rural areas since this study only limited itself to micro and small enterprises operating in a town in this case Murang’a town. The researcher also recommends research on factors affecting provision of financial services to micro and small enterprises by microfinance institutions in Kenya.
REFERENCES


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Khan A.A (2008), Islamic Microfinance; Theory, policy and Practice. Islamic Relief World, Birmingham, United Kingdom.


Appendix I: Letter of Introduction

James Mwangi Njau
Kenyatta University
P.O. Box 43844 – 00100
Nairobi.
8th September, 2011.

RE: COMPLETION OF QUESTIONNAIRE

I am an MBA student (entrepreneurship option) at Kenyatta University carrying out research on financing of micro and small enterprises by microfinance institutions as part of my project which is a requirement for the award of the degree.

The purpose of the survey is to investigate microfinance factors affecting performance of MSEs financed by microfinance institutions. This information is important for the use by various stakeholders to enhance financing by this important sector and hence stimulate its growth.

Please complete the attached questionnaire as honestly as possible to the best of your knowledge. Try and answer all the questions even if you feel some may not apply directly to your enterprise. Your answers are essential in providing a true picture of micro and small enterprises financing by microfinance institutions. All information is solely for this project and will be treated in confidence.

Yours faithfully,

James Mwangi, MBA student, Kenyatta University.
Research Questionnaire

The purpose of this survey is to investigate microfinance factors affecting performance of MSEs financed by microfinance institutions. This information is important for the use by various stakeholders to enhance financing by this important sector and hence stimulate its growth.

Please complete the attached questionnaire as honestly as possible to the best of your knowledge. Try and answer all the questions even if you feel some may not apply directly to your enterprise. Your answers are essential in providing a true picture of micro and small enterprises financing by microfinance institutions. All information is solely for this project and will be treated in confidence.

1b) QUESTIONNAIRE

(Please write your answer tick (√) where appropriate.)

Part 1: Characteristic of business

1. Name of the business.................................................................

2. Sub-sector

e.g. metalwork.................................................................

3. Gender of respondent Male □ Female □

4. Marital status Married □ Single □

5. Type of business ownership

Sole □ Partnership □ Others (specify) □

6. Number of employees

0-9 □ 9-20 □ Above 20 □
7. How long have you operated this business?

- Less than 1 year
- 1-5 years
- 6-9 years
- 10-15 years
- Above 15 years

8. What is your highest level of formal education attained?

- No formal education at all
- Primary
- Secondary
- College

9. Is your business legally registered?

- Yes
- No

Part 2: Business Training by Microfinance Institutions

10. Have you ever applied for credit from Microfinance institutions?

- Yes
- No

11. If your answer is yes in (a) above, did you receive training as a prerequisite for approval of your loan application?

- Yes
- No

12. To what extent was the training relevant to your business?

Scale: No Effect=0, To a low Effect=1, To a low extent=2, To a great extent=3, To a very great extent=4

- No effect
- To a low extent
- To a great extent
- To a very great extent
13. Indicate how the training helped you to improve the performance of the business.

i. Acquired business management skills. 

ii. Proper utilization of loan.

iii. Marketing of business products.

iv. Keeping business records.

v. Any other (specify) .................................................................

........................................................................................................

Part 3: Microfinance Products and Services

14. Please indicate microfinance products that your business has benefited from microfinance institutions.

- Micro credit product
- Micro insurance health product
- Micro insurance assets product
- Micro Saving product (cash deposit)
- Any other (specify) .................................................................

15. Were you charged any fee in order to receive the microfinance product you applied for?

Yes  No

16. Were you satisfied by the microfinance product?

Yes  No

17. If your answer is no in the above question, indicate reason(s) why you were not satisfied.

- High processing fee
- Long and tedious application process
Bank account monthly ledger fees  

Any other (Specify) .................................................................

18. To what extent did the microfinance products and services affect your business performance?
No effect ☐ To a low extent ☐ To a great extent ☐ To a very great extent ☐

19. Suggest how microfinance institutions can improve their products and services .................................................................
...................................................................................................
...................................................................................................

Part 4: Cost of Credit

20. Were you charged any fee when you applied for microfinance credit from Microfinance institution?
Yes ☐ No ☐

21. What was the interest rate on the microfinance credit
   Below 10% ☐
   Between 11% - 14% ☐
   Between 15% - 19% ☐
   Above 20% ☐

22. In your own opinion, do you think microfinance institutions charge high interest rates?
   Yes ☐ No ☐

23. How much time were you given by the Microfinance institution to repay the loan?
   Below 1 year ☐
   Between 1-2 years ☐
   Above 2 years ☐
24. To what extent did the payment of the loan affect your business performance?

No effect [ ] To a low extent [ ] To a great extent [ ] To a very great extent [ ]

Part 5: Loan Lending Method

25. Indicate the loan lending method that was applied by the Microfinance when you applied for a loan

Individual lending method [ ]

Group lending method [ ]

26. If you have been using the group lending method to apply for loan, has any member of your group defaulted loan payment?

Yes [ ] No [ ]

27. If your answer is yes in the above question, were the group members asked to pay the loan defaulted?

Yes [ ] No [ ]

28. Have you ever been disqualified from accessing credit from Microfinance institutions because you were not a member of a business group.

Yes [ ] No [ ]

29. To what extent did the loan lending method affect your business performance?

No effect [ ] To a low extent [ ] To a great extent [ ] To a very great extent [ ]
## Appendix 2

### Research Schedule (Work Plan)

<table>
<thead>
<tr>
<th>Activity</th>
<th>Time in month</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Project writing</td>
<td>1</td>
</tr>
<tr>
<td>2. Department defense and corrections</td>
<td>1</td>
</tr>
<tr>
<td>3. Field work</td>
<td>1</td>
</tr>
<tr>
<td>4. Data analysis</td>
<td>1</td>
</tr>
<tr>
<td>5. Report writing and submission</td>
<td>1</td>
</tr>
</tbody>
</table>
### Appendix 3

#### Budget

<table>
<thead>
<tr>
<th>ITEM</th>
<th>DETAILS</th>
<th>AMOUNT</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>project writing</strong></td>
<td>Secretarial services</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Typing proposal</td>
<td>6,000.00</td>
</tr>
<tr>
<td></td>
<td>Typing final report</td>
<td>4,000.00</td>
</tr>
<tr>
<td></td>
<td>Photocopying</td>
<td>3,400.00</td>
</tr>
<tr>
<td></td>
<td>questionnaires</td>
<td></td>
</tr>
<tr>
<td><strong>Data collection</strong></td>
<td>Travelling expenses</td>
<td></td>
</tr>
<tr>
<td></td>
<td>To present questionnaires</td>
<td>4,000.00</td>
</tr>
<tr>
<td></td>
<td>Administration of questionnaires</td>
<td>3,000.00</td>
</tr>
<tr>
<td></td>
<td>To consult the supervisor</td>
<td>4,000.00</td>
</tr>
<tr>
<td><strong>Data analysis</strong></td>
<td>Computer analysis services</td>
<td>6,000.00</td>
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<tr>
<td><strong>Binding the proposal</strong></td>
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<tr>
<td></td>
<td>Binding the final report</td>
<td>4000.00</td>
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<tr>
<td><strong>Total</strong></td>
<td></td>
<td>30,400.00</td>
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