

**MICROFINANCE SERVICES AND FINANCIAL PERFORMANCE OF SMALL AND  
MEDIUM ENTERPRISES; CASE OF KILIFI TOWN, IN KENYA**

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UNIVERSITY**

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**DECLARATION**

This research project is my original work and has not been presented to any other examination body. No part of this research should be reproduced without my consent or that of Kenyatta University.

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## **DEDICATION**

This research project work is dedicated to the Almighty God who gave me knowledge, good health and strength to carry out this work successfully. Also to my loving family members who have been very supportive throughout my studies and in this research work.

To my colleagues at the work place, who have encouraged me all through during this period.

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May the Lord splendidly bless you all.

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## **OPERATIONAL DEFINITION OF TERMS**

<b>Credit facilities</b>	loans, overdrafts and other forms of lending from microfinance institutions extended to small and medium enterprises
<b>Financial Literacy</b>	Possessing the knowledge necessary to understand concepts related to finance among Small and Medium Enterprises. These ideas may include balancing a checkbook, understanding interest rates, employee benefits, or how the stock market works.
<b>Financing</b>	Providing the necessary capital required for Small and Medium Enterprises
<b>Growth and Development</b>	Expansion among Small and Medium Enterprises in terms of number of employees, revenues per annum and number of outlets
<b>Managerial skills</b>	ability and knowledge on running and managing of a business enterprise by SME owners
<b>Market facilitation</b>	The process by which SMEs are assisted to get market for their products and services by connecting them with potential buyers and logistics
<b>Microfinance Institution</b>	An organization that provides financial services to low income clients, including the self employed.
<b>Small and Medium Enterprise</b>	any enterprise employing below 100 employees

## **ABBREVIATIONS AND ACRONYMS**

<b>CGAP</b>	Consultative Group to assist the Poor
<b>EU</b>	European Union
<b>GDP</b>	Gross Domestic Product
<b>IBP</b>	Individual Banking programmes
<b>ICT</b>	Information Communication Technology
<b>KIM</b>	Kenya Institute of Management
<b>KWFT</b>	Kenya Women Finance Trust
<b>MFI</b>	Microfinance Institutions
<b>NGO</b>	Non Governmental Organization
<b>SHG</b>	Self Help Group
<b>SME</b>	Small and Medium Enterprises
<b>SMEP</b>	Small and Medium Enterprise Program
<b>WEEC</b>	Women Economic Empowerment Consort

## ABSTRACT

Small and Medium Enterprises continue to fail from the problems that Microfinance Institutions claim to offer solutions to. A survey by Kenya National Bureau of statistics, (2016 ) indicates that three out of five Small and Medium Enterprises businesses fail within the first few months of operation. A gap exists in finding out the effect of Microfinance Institutions and financial performance of Small and Medium Enterprises. This study therefore sought to establish the effect of microfinance services by microfinance institutions on the performance of small and medium enterprises. The study was guided by the following objectives; to find out the effect of credit facilities, provision of financial literacy, development of management skills and market facilitation on the performance of Small and Medium Enterprises in Kilifi Town. The study was expected to establish the practical role of perceived solutions provided by microfinance institutions and how this affects growth of Small and Medium Enterprises. The study was anchored on Resource based theory and the dynamic capability theory of the firm. A survey design was used to accomplish the study objectives. Data was gathered from managers of Microfinance I institutions as well as Small and Medium Enterprises within Kilifi Town. Stratified sampling was adopted to select 66 Small and medium Enterprises and five microfinance institutions to participate in the study. Data was collected via a questionnaire whose validity and reliability was established in the pilot test. Quantitative data analysis was undertaken to generate both descriptive and inferential statistics, this was done using statistical package for social sciences (SPSS). Presentation of data was done in tables and interpretation made based on research objective. The Small Medium Enterprises are significantly aware of the services offered by the microfinance institutions. 89.7% of changes in financial performance of SMEs in Kilifi Town are explained by the independent variables of the study as indicated by an R square of 0.897. From the regression coefficients, the selected microfinance services by the MFIs in Kilifi County have a positive and significant influence on the financial performance of SMEs. The study concluded that the microfinance institutions have not done much in ensuring that their services reach and are appreciated by Small Medium Enterprises in the town. Credit facilities and financial literacy have significantly been extended to the Small Medium Enterprises by the microfinance institutions but development of managerial skills and market facilitation have not been done to expectations. The study recommends sensitization of the Small Medium Enterprises before credit extension to them through extensive financial literacy training and managerial skills development by the MFIs.

# **CHAPTER ONE**

## **INTRODUCTION**

### **1.1 Background of the study**

The microfinance revolution came about more than two decades ago with an aim of catapulting development in various arenas of the economy. However, the spread off the adoption of the microfinance model did not happen until mid 1990s. During this time, microfinance programmes and institutions came up and aimed to foster that growth of many micro-enterprises, especially in developing countries. The term micro-finance was defined by the United Nations in the year 2005 as basic financial services such as savings, credit and insurance. This concept enabled people to borrow, invest, and protect their families against various forms of risk. As observed, microfinance institutions are not only useful for levying credit but also aim at levying the accumulation of assets for poor people. Harper (2003) explains that the aspect of microfinance originated from Bangladesh at around 1976 as a result of the pioneer research conducted by Dr. Muhammad Yunis who was a professor of Economics.

Globally, Small to Medium Size Enterprises (SMEs) are being hailed for their pivotal role in promoting grassroots economic growth and equitable sustainable development. In the United States of America (USA) and European Union (EU) countries Small Medium Enterprises are enterprises with employees under 500 while in developing countries any enterprise employing below 100 employees would constitute a Small Medium Enterprise. Small Medium Enterprises have become more important in the economic matrixes in recent years across the globe through increased deliberate government policies and legislation aimed at nurturing Small Medium Enterprises as engines of economic growth and employment creation. It is estimated that Small Medium Enterprises constitute over 90 percent of total enterprises in most economies with a high

rate of employment growth. They are also a vehicle for increased industrial production and exports.

In the USA and EU countries it is estimated that Small Medium Enterprises contribute over 60 percent in employment, 40-60 percent to Gross Domestic Product (GDP) and 30-60 percent to exports. The Asian countries such as India, Indonesia, China, Malaysia, Japan, and South Korea also have thriving Small Medium Enterprises sectors contributing between 70-90 percent in employment and an estimated 40 percent contribution to their respective Gross Domestic Products. In Africa, economic powerhouses such as South Africa, Egypt, Nigeria and Kenya, the Small Medium Enterprises sector is estimated to contribute over 70 percent in employment and 30-40 percent contribution to Gross Domestic Product, but contribute less than four percent to export earnings.

The small and medium enterprises (SMEs) play an important role in the Kenyan Economy. According to the Economic Survey (2006), the sector contributed over 50 percent of new jobs created in the year 2005. Despite their significance, past statistics indicate that three out of five businesses fail within the first few months of operation (Kenya National Bureau of Statistics, 2016 ). Among the inexhaustible list of factors that could enhance development of Small and Medium Enterprises is adequate finances and good financial management among the Small and Medium Enterprises. Finance and financial related services are an important prerequisite in initiation, development and growth of business enterprises. Every business whether large, medium or small requires some level of financing in order to sustain its operations and expand. Financial institutions provide finance solutions to facilitate the aforementioned business requirements. With large business enterprises, it is not a difficult task to obtain financing from financial

institutions and hence can easily walk into banking facilities and get loans to finance their business operations, Ledgerwood (2016 ).

A survey done by the World Bank (2005) confirms that generally, large firms have access to bank credit and other financial services both local and foreign than small firms. The situation is however, different for Small and Medium Enterprises who heavily rely on internal funds and retained earnings. The issue of formal microfinance lending has existed in Kenya since 1950s as a result of a Joint Loan Board Scheme established by the colonialists (Kitabu, 2016 ). Just after Kenya gained independence, the government of Kenya embarked on a program which aimed to ensure that people from rural settings were provided with credit services. This factor influenced other financial institutions to venture into the practice drawing profits and helping to enrich the rural communities as a result.

The inception of microfinance institutions was convenient in the growth of small and medium enterprises since large banks usually transact with large and middle companies due to reduced risks associated with them. Small and Medium Enterprises are also associated with poor creditworthiness which most commercial banks tend to shy away from. These institutions are, therefore, a major form of funding for small and medium enterprises in the entire of Africa and other developing countries.

As of the year 1999, Kenya had 1.3 million small and medium enterprises employing about 2.3 million people in Kenya. This accounts for about 20% percent of all employed people. According to the National micro and small enterprise baseline for 2013, there is a great relationship between microfinance institutions and Small and Medium Enterprises in Kilifi County (Kilifi Blog, 2015).

### **1.1.1 Microfinance Services in Kenya**

Microfinance is termed as development tool which gifts administrations and items, for example, extremely investment fund, little advances little protection and cash move to help with setting up and extending organizations of the low pay people (Mbithe, 2013). It likewise alludes to the idea of arrangement of little size administrations particularly to the lower portion of the rustic and urban populace (Hudon, et al, 2016). Also microfinance is seen as the arrangement of money related and non-benefits by MFIs to low salary bunches without unmistakable security yet whose exercises are connected to pay creating wanders (Olowe, *et al*, 2013).

In Kenya the microfinance organizations, which give the microfinance administrations, are under the rules of the Kenyan Micro Finance Act, which was actualized in 2006 and was dynamic in 2015 (RoK, 2015). With the appropriation of this demonstration, numerous organizations could apply for smaller scale bank licenses at the Central Bank of Kenya either as a group or national establishment. As of now, in Kenya there are 24 substantial small scale bank foundations. Act. The five biggest establishments are: Equity Bank with a piece of the overall industry of 73.50%, Kenya Women Microfinance Bank (KWFT): with a piece of the pie of 12.06%, K-Rep Bank with a piece of the pie of 6.39%. There is also Faulu with a piece of the overall industry of 3.56% and Jamii Bora that has a piece of the pie of 0.86% in light of their gross advance portfolio (Curtis, 2012).

Microfinance money related exercises include: little advances for the most part to work capital, casual endorsement of borrowers and speculations, insurance substitutes, for example, a gathering ensure or obligatory investment funds, access to rehash and huge credits in light of reimbursement execution, streamlined advance payment and checking and secure sparing items (Olowe, et al, 2013). The Small and Medium Enterprises' proprietors likewise advantage from

capital venture choices, for example, designation of the miniaturized scale endeavor constrained capital subsidizes most successfully so as to guarantee the most ideal return.

Those administrations gave by microfinance establishments to customers can be sorted into our gatherings .The gatherings are money related intermediation, arrangement of monetary items and administrations, for example, credit, reserve funds, protection, installment framework and Visas which ought not require on-going sponsorships (Maengwe and Otuya, 2016). The accompanying are qualities of Microfinance Institutions: Loans are normally under 12 months much of the time and are for the most part to work capital with quick consistent reimbursements generally week by week or month to month. After endorsement they are dispensed rapidly, for the most part for those looking for rehash advance. Consequently the accommodation Microfinance Institutions benefits as a wellspring of capital for generally Small and Medium Enterprises.

### **1.1.2 Financial performance of Small and Medium Enterprises**

West and Fair (2006), define performance as a function of an organization ability to meet its goals and objectives by exploiting the available resources in an efficient and effective way. Studies by Whyte (1991), show that performance can be measured at both organization and individual levels and this measurement is sometimes referred to as performance appraisal. He urges that organizations have desired potentials in terms of capacity attraction, market share and financial strength and that performance is the difference between those potentials and what has been achieved. The World Bank defines financial self sustainability as the process of increasing the capacity of institutions or groups to make choices and to transform those choices into desired actions and outcomes (Montgomery, 2005). Central to this process are actions which both build individual and collective assets, and improve the efficiency and fairness of the organizational and institutional context which govern the use of these assets.

In order to ensure financial viability, sustainability needs to be central in the planning and day-to-day operation of the Small and Medium Enterprises. Indeed, financial sustainability can be considered as an important dimension as it is a condition for achieving sustainability of other project components (Salman, 2015 ). It is achieved if the revenues of the Small and Medium Enterprises are greater than the expenditures. However, financial sustainability is an output of the sustainability of other components at the same time.

Financial sustainability is a key factor for Small and Medium Enterprises sustainability, as it is a condition for achieving sustainability of other components and the survival of the Small and Medium Enterprises (Todd, 2006). Moreover, financial sustainability is based on a given minimum purchasing power and sufficient density of potential Small and Medium Enterprises customers. In addition to budgeting, bookkeeping, and strict financial discipline Small and Medium Enterprises should establish financial controlling mechanisms keeping them informed of the status of planned vs. actual expenditures, earnings, and cash flows.

### **1.1.3 Microfinance Services and Financial performance**

Accessing credit is considered to be an important factor in increasing the development of Small and Medium Enterprises. It is thought that credit augments income levels, increases employment and thereby alleviates poverty. It is believed that access to credit enables poor people to overcome their liquidity constraints and undertake some investments such as the improvement of farm technology inputs thereby leading to an increase in agricultural production (Hiedhues, 1995).

A number of studies have observed that savings-led groups perform better than credit-led ones (Allen 2005; Murray and Rosenberg 2006; Ritchie, 2016 ). Access to micro-finance has the potential to assist the poor in earning income from microenterprises, smooth their income and consumption (Zeller, 1999), help households diversify their income sources. (Anand et al, 2005).

According to Mosley (2000) microfinance makes a considerable contribution to the reduction of poverty. It helps increase income earning and asset building opportunities which make households less reliant on a single asset type and consequently deal with disasters (Anand et.al, 2005). According to Hassan (2002), many Grameen Bank borrowers were actually building larger houses. Panganiban (1998) advances that the income of borrowers has risen and their assets base has widened. Investments made by loans appear to have been extremely productive and to have contributed significant improvements in household output, income and consumption (Ghai, 1984). In Tegucigalpa and Cholteca in Honduras in 2003, effect assessment studies revealed that 60% and 50% of the recipients had their sales and incomes increase respectively one year after receipt of credit for working capital. Agricultural Finance Cooperation Limited in 2015 in India, assessed development effect of microfinance programmes. Clients reported increase in income from 76% of activities. There is therefore reason to believe microfinance services in its entirety should report effect on savings, income and investments alongside non-financial study was specific in investigating these aspect.

## **1.2 Statement of the problem**

Many parts of Kenya are built by small and medium enterprises. However, they have a high mortality rate due to lack of sufficient financing from financial institutions. Over 60% of small and medium enterprises collapse within a year of being established (KNBS, 2016 ). Small and Medium Enterprises continue to fail from the problems that Microfinance Institutions claim to offer solutions to. A gap exists in finding out the effect of Microfinance Institutions and growth and development Small and Medium Enterprises. The poor health of the economy as well as poor relationship between the businesses and financial institutions is among the causes of such a situation. Also, despite the much effort prompted by the government to the informal sector, there

is still more that needs to be done so as to heighten the growth of the small and medium enterprises. The department of micro- and small enterprise development estimates that there were close to 2.8 businesses in the year 2002. This number increased drastically within the subsequent years, although a big gap still lies in place.

Wachira (2013) in his study on the effect of MFIs on the growth and development of SMEs, he established that services by MFIs have created a stable environment for SMEs to thrive. MFIs provide loans which aid the SMEs in getting seed capital to expand and grow however the study did not establish how the various services apart from loans assist SMEs to perform and be competitive. Ngechu (2010) similar in his study established the MFIs provide solutions to SMEs through provision of financing, literacy skills, development of management skills and market facilitation but did not establish the influence it has on the performance of the enterprises which this study sought to find out.

Kilifi town has had an upsurge of business units in the previous years. However, this factor has not meant the survival of individual business units. The heavy presence of financial institutions in the town in the recent times has also prompted the research into their relationship with the small and medium enterprises (Kilifi Blog, 2015).

### **1.3 Objectives of the study**

#### **1.3.1 General Objective**

The general objective of the study was to establish the influence of microfinance services on the financial performance of Small and Medium Enterprises in Kilifi County.

#### **1.3.2 Specific Objectives**

The study was guided by the following specific objectives;

- i. To establish the effect of credit facilities and financial performance of small and medium enterprises in Kilifi County.
- ii. To investigate the influence of financial literacy and financial performance of the small medium enterprises in Kilifi County.
- iii. To assess the effect of development of managerial skills and financial performance of small and medium enterprises in Kilifi County.
- iv. To establish the effect of market facilitation and financial performance of small and medium enterprises in Kilifi County.

#### **1.4 Research questions**

The study sought to answer the following questions

- i. What is the effect of credit facilities on the financial performance of Small Medium Enterprises in Kilifi County?
- ii. What is the effect of financial literacy on the financial performance of Small Medium Enterprises in Kilifi County?
- iii. What is the effect of development of management skills on the financial performance of Small Medium Enterprises in Kilifi County?
- iv. What is the effect of market facilitation on the financial performance of Small Medium Enterprises in Kilifi County?

#### **1.5 Significance of the Study**

The importance of Small and Medium Enterprises in economic development and poverty reduction cannot be ignored. By undertaking the present study, the researcher sought to establish the practical role of perceived solutions provided by microfinance institutions and how this affected financial performance of Small and Medium Enterprises. The study sought to

recommend possible strategies that may help improve Micro finance Institutions' impact on Small and Medium Enterprises. The information from the present study acted as feedback to microfinance institutions that provide financial solutions to Small and Medium Enterprises. This would facilitate formulation of strategies based on Small and Medium Enterprises needs but not out of general perception of what Small and Medium Enterprises need. The study acted as an awareness programme among Small and Medium Enterprises owners and managers who might not be aware of the services and products provided by microfinance institutions.

### **1.6 Scope of the study**

The scope of the study was on the influence of service by micro finance services on the financial performance of Small and Medium Enterprises in Kilifi County. The study targeted 66 Small and Medium Enterprises in Kilifi Kenya whose proprietors or managers formed the study population. It was believed that this would provide adequate information for the study and therefore gave reliable results and findings.

### **1.7 Limitations of the study**

The study was limited to the four main services provided by MFIs which include credit facilities, financial literacy training, managerial skills development and market facilitation since they are the most profound areas that MFIs concentrated on. The study findings were limited to respondents' level of literacy in provision of responses to the research questionnaire however the objectives of the study were explain to them before data collection. The findings were further limited to extent of services offered by microfinance institutions to Small and Medium Enterprises within Kilifi Town.

### **1.8 Organization of the study**

This research project comprised of five chapters. Chapter one involved background of the study, statement of the problem, purpose of the study, objectives of the study, research questions, and significance of the study, limitation of the study, assumptions of the study and organization of the study. Chapter two reviewed; theoretical review, empirical review and research gaps and Chapter three dealt with research methodology which explained the research design, target population, sampling design, rationale for sample selection, data collection instruments, questionnaires, validity of the research instrument, reliability, data analysis and ethical considerations while chapter four had presentation of findings and discussions. Chapter five covered the summary of findings, conclusions and recommendations.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.1 Introduction**

This chapter summarizes the information from other researchers who have carried out their research in the same field of study. The specific areas covered here are theoretical literature, empirical review on Small and Medium Enterprises performance. The chapter will also review literature on the existing knowledge and theories that have contributed to the understanding of micro credit and Small and Medium Enterprises performance.

#### **2.2 Theoretical Review**

The study was anchored on the resource based view theory and dynamic capabilities theory discussed below:

##### **2.2.1 Resource Based View**

Barney, Wright and Ketchen (2001) noted that every firm owns a diverse outline of tangible and intangible resources. Barney is one of the late contributors of Resource Based View who studied and established the existence of key firm resources for superior performance. The theory of Resource Based View assumes that individuals are inspired to make maximum use of economic resources available and rational choices that a firm makes which are shaped by economic framework (Barney, 2016 ). Resource Based View theory in this study played a role of evaluating and explaining resources and capability of a firm that have the capability to create and maintain a firm's advantage and thus higher performance among the mobile phone industries in Kenya (Sheehan & Toss, 2016 ).

Complex packages of skills, obtained knowledge, ability and experience that facilitate the company to manage activities of the firm and make use of resources to create performance through coordinating and putting resources into proper production use is what defines capability

(Amit and Shoemaker 1993; Barney, 2016 and Mckelvie and Davidsson, 2013 ). According to Lockett, Thompsons and Morgensrern (2013 ) on strategic management, Resource Based View scrutinizes the resources and abilities that facilitate how the firm will produce above the ordinary rates of return and higher performance benefits.

The theory of Resource Based View contributes in enabling the firm managers to check whether factors relevant to superior performance exist or not. This enables them to be in a position of exploiting market imperfection to advance their performance. That way, managers are put in a place where they can combine resources to sustain their performance advantage. Resource Based View theory provides the benefit to the firm specifically highlighting factors that create superior performance for a firm (Locket, Thompson and Morgenstern, 2013). Resource Based View allows executives of the organization to choose the most important strategic factors to invest in from a given range of probable strategic factors in the mobile telephone industry.

Barney and Hesterly (2010) advanced that resources in general include the following key constructs: resources, capabilities and competences. In strategic management literature, resources are defined as stocks of accessible things that are possessed by the firm. Competencies are the firm's strengths that enable it to better differentiate its products or service quality by building technological system to respond to customers' needs, hence allowing the firm to compete more efficiently and successfully than other firms (Defillippi, 1990; Arend and Levesque, 2010 and Anderson, 2011). Resource Based View has contributed in strategic management through its emphasis on firm-specific resources as bona fide source of high performance (Mckelvie & Davidsson, 2013 ).

For a firm to have a superior performance, resources and capabilities have to qualify as exceedingly valuable, rare, inimitable, and non-substitutable. Resources that are valuable add to

advancing the firm's performance. Rareness creates ideal competition in view of the fact that resources in that category are possessed by fewer firms. Inimitable resources are costly to duplicate and non-substitutable, meaning that there is no alternative to accomplishing an equal function instantly available to competitors (Barney 2016 , Barney and Hesterly, 2010). Tangible resources are physical substances that an organization possesses such as facilities, raw materials and equipment. Intangible resources include corporate brand name, organizational values, networks and processes that are not included in normal managerial-accounting information. Intangible resources are more likely to generate competitive advantage and superior performance as compared to tangible resources (Rouse & Daellenbach, 2014 & Kenneth et al., 2011).

### **2.2.2 The Dynamic Capability theory of the Firm**

The Dynamic Capabilities View of a firm, which was launched by David Teece in early 1990s, is based on the works of Barney (1986). The framework is an advancement of the Resource-Based View (RBV) of the firm which views resources as the key to superior organization performance. The dynamic capability theory is based on the concept that organizations will always attempt to renew their resources in a way that suits the changes taking place in a dynamic environment. According to (Teece, Pisano and Shuen 2005), the dynamic capability view examines how firms are able to integrate, build, and reconfigure their specific competencies (internal or external) into new competencies that match changes taking place in a turbulent environment. The theory is based on the assumption that firms with greater dynamic capabilities will always outperform those with smaller dynamic capabilities.

Therefore, operations in a dynamic environment call for firms to continuously renew re-engineer and regenerate their internal and external firm's specific capabilities in order to remain competitive (Barney, 2007). The dynamic capabilities are hard to develop and difficult to

transfer because they are tacit and are embedded in a unique set of relationships and histories of a firm. Ordinary capabilities, according to Resource Based View, are about doing things right whereas dynamic capabilities are about doing right things at the right time based on unique processes, organizational culture and prescient assessments of the business environment and technological opportunities surrounding a firm. Strong dynamic capabilities include processes, business models, technology, and leadership skills needed to effectuate high performance sensing, seizing and transforming an organization.

The literature review provided a review of past studies on; the business model for microfinance institutions, the situation for Small and Medium Enterprises in Kenya, and empirical review of the effect of various microfinance services i.e. financing, provisions of financial literacy, and developments of management skills among Small and Medium Enterprises in facilitation of market network among Small and Medium Enterprises. The chapter also discussed the interrelationship between the study variables in the conceptual framework.

## **2.3 Empirical Review**

This part reviewed various studies done on provision of credit facilities, financial literacy, development of management skills and market facilitation on performance of Small and Medium Enterprises.

### **2.3.1 Provision of Credit facilities and financial performance Small and Medium Enterprises**

Various attempts have been done to examine the effect of financing Small and Medium Enterprises by microfinance institutions on growth and development of Small and Medium Enterprises. Maina (2012) did a survey on microfinance services contribution to entrepreneurial development in Kenya. The study employed a case study design and focused on Small and

Medium Enterprises within Nairobi. Maina noted that the banking sector in Kenya is fairly vibrant by the standards of developing third world countries.

However, the sector is 90% emphatically dominated by the formal commercial banks. Credit policy for banking institutions catered mainly for big businesses only, thus implying lack of access to credit facilities for small and medium enterprises. Maina study further observed that MFIs had come up to address the gap in finance requirements for Small and Medium Enterprises (SME). The study finding indicated the microfinance institutions intervention to Small and Medium Enterprises financing was faced by hurdle of Lack of collateral and inappropriate legal and regulatory framework that does not recognize innovative lending policy to coupled with limited access to credit and financial services, there was no structural institutional mechanism to facilitate flow of financial resources from banks to Microfinance Institution, and then to the Small and Medium Enterprises hence increasing cost of credit.

### **2.3.2 Provision of Financial Literacy and financial performance of Small and Medium Enterprises**

Financial literacy among Small and Medium Enterprises owners and managers is critical in ensuring that Small and Medium Enterprises grow from small and medium to large enterprises. According to a report by Financial Sector Deepening 2013, Small and Medium Enterprises finance capacity is a critical component in expanding Small and Medium Enterprises finance. The report noted that some Microfinance Institutions were involved in enhancing the capacity for Small and Medium Enterprises through financial literacy training. It was however noted in Financial Sector Deepening report that attempting to build this capacity at an institutional level was unlikely to be sustainable and certainly an expensive approach among Microfinance Institutions. Thus as much as Microfinance Institutions wish to provide Small and Medium Enterprises capacity to handle finances, most of them are limited by the costs associated and the

likelihood of passing this cost to the final consumer reduces original concept of providing affordable financing to Small and Medium Enterprises.

### **2.3.3 Development of Management skills and financial performance of Small and Medium Enterprises**

Management of Small and Medium Enterprises is a likely intervention that microfinance institutions are expected to offer in a bid to provide solution to many inadequacies that Small and Medium Enterprises face. According to Armyx, 2005 Small and Medium Enterprises face unique challenges, which affect their growth and profitability and hence, diminish their ability to contribute effectively to sustainable development. Among such challenges as highlighted by is lack of managerial training and experience (Wanjohi, 2016 ). He noted that a typical owner or managers of small businesses develop their own approach to management, through a process of trial and error. As a result, their management style is likely to be more intuitive than analytical, more concerned with day-to-day operations than long-term issues, and more opportunistic than strategic in its concept (Hill 1987). Although this attitude is the key strength at the start-up stage of the enterprise because it provides the creativity needed, it may present problems when complex decisions have to be made.

A consequence of poor managerial ability is that Small and Medium Enterprises owners are ill prepared to face changes in the business environment and to plan appropriate changes in technology. Majority of those who run Small and Medium Enterprises are ordinary lot whose educational background is lacking. Hence they may not well equipped to carry out managerial routines for their enterprises (McGrath, 2002). According to Mugure, (2015 ) some educational institutions have made attempts to incorporate managerial training among Small and Medium Enterprises. There is however little known about how Microfinance Institutions are imparting

business management skills among Small and Medium Enterprises and how this has affected their growth and development.

#### **2.3.4 Market facilitation and financial performance of Small and Medium Enterprises**

Lack of sufficient market information poses a great challenge to small enterprises. Despite the vast amount of trade-related information available and the possibility of accessing national and international databases, many small enterprises continue to rely heavily on private or even physical contacts for market related information. This is due to inability to interpret the statistical data and poor connectivity especially in rural areas (Mwangi, 2013). Since there is vast amount of information and only lack of statistical knowledge to interpret and Internet connectivity, small enterprises entrepreneurs need to be supported. Belonging to a professional body helps gain a competitive advantage in a business. Being a member of an industry association implies that one is serious about the business they do. This could also help in networking and obtaining of business information. In addition to offering financial products, microfinance institutions can provide a link to between client and Microfinance Institutions through formation of business clubs, marketing associations and practicing development of well update data bases on Small and Medium Enterprises information, their products and services. Little has been discussed on how enhanced Small and Medium Enterprises network and accessibility of market information provided by Microfinance Institutions have contributed towards growth and development of Small and Medium Enterprises.

#### **2.4 Summary of literature Reviewed and gaps**

The reviewed literature provides a discussion of microfinance institutions and their models of product provision. In the perspective of author's reviewed and within the context of the present study, microfinance is viewed as provision of broad range of financial services such as deposits,

loans, payment services, money transfers and insurance products to poor and low income households. Microfinance is classified based on the type of client, lending technology, loan portfolio organizational ideology and instructional structure. Micro financing is based on the premise that mainstream traditional banking cannot reach millions of poor for whom small loans and other financial products would make a difference. This is further build on the assumption that the poor are willing to pay higher cost of financial services since they cannot enjoy large scale production discounts like large companies. Microfinance Institutions provide solutions to Small and Medium Enterprises through provision of financing, literacy skills, development of management skills and market facilitation (Ngechu, 2010).

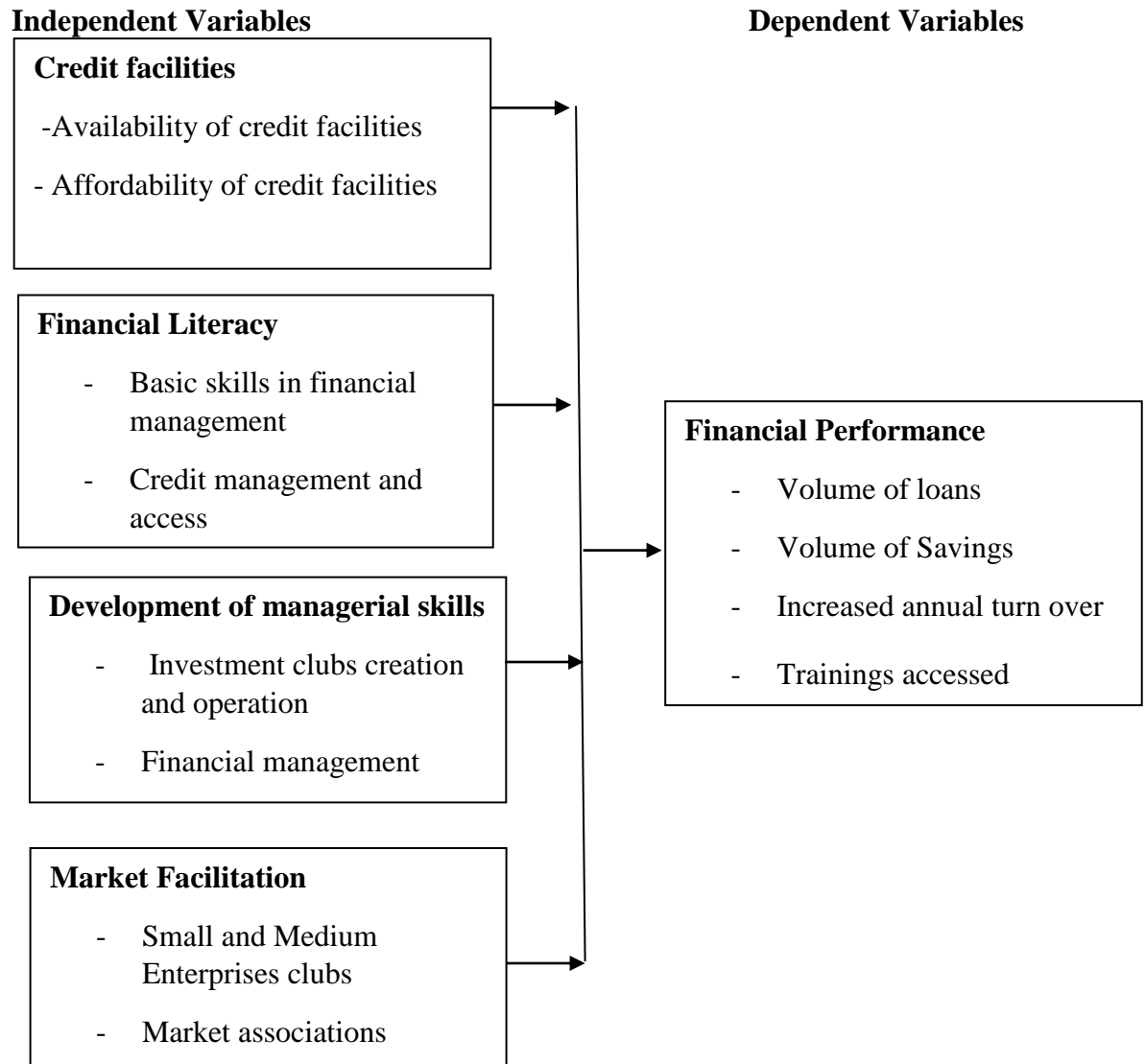
According to Wachira (2013), the area of Microfinance Institutions in relation to their impact on Small and Medium Enterprises has been significantly researched. Nevertheless, a gap still remains in establishing the effect of Micro Finance Institutions in relation to growth and development of Small and Medium Enterprises. In the quest of establishing the impact of Small and Medium Enterprises and how they are related with Microfinance institutions, researchers have a wide evidence of the challenges faced by Small and Medium Enterprise, the working model for Microfinance Institutions and range of services that provide solution to Small and Medium Enterprises problems. There is however little evidence to establish the relationship between services provided by Small and Medium Enterprises and growth of Small and Medium Enterprises. This study therefore sought to fill the gap by examining the impact of microfinance institutions on growth and development of small and medium enterprises in Kenya.

**Table 2.1 Summary of Literature Review**

<b>Author</b>	<b>Year</b>	<b>Topic</b>	<b>Findings</b>	<b>Knowledge gap</b>
<b>Nyangilo</b>	2012	Effects of Micro credit on women empowerment	Access to finance has a positive effect on women entrepreneurial projects	Did not focus on performance indicators
<b>Lepartobiko</b>	2012	Financial inclusion and performance of Microfinance Institutions	Inclusivity has a positive impact on profitability	Did not focus on Micro Finance
<b>Kibuchi and Muchungu</b>	2012	Emerging trends in economics and management of Microfinance Institutions	Trends in economics have an impact on Microfinance Institutions	The study did not focus on performance indicators
<b>Kibuchi and Muchungu</b>	2012	Contribution of human factors in the performance Microfinance Institutions	Influence exists where the leader is powerful and charismatic	Did not focus on microfinance

## **2.5 Conceptual framework**

A conceptual framework is defined by Kothari (2004) a structure that presents relationship between the main constructs in a given study. Mugenda (2003) further adds that a conceptual framework gives an explanation of how the researcher perceives the relationship between variables deemed to be important in a study. Such relationship in the present study has been discussed in figure 2.1 below



**Figure 2:1 Conceptual Framework**

*Source: Author, 2017*

Figure 2.1 above represents the study's independent and dependent variables. Financial performance of Small and Medium Enterprises is subject to various solutions provided by microfinance institutions. In the case of this study, microfinance institutions are assumed to offer favorable Small Medium Enterprises financing through credit and offer draft facilities, develop financial literacy skills among Small Medium Enterprises owners, develop management skills among Small Medium Enterprises, and facilitated marketing and marketing techniques among

small and medium enterprises. This services provided by microfinance institutions and which forms the study independent variables are considered to be important determinant of the growth and development directions that Small Medium Enterprises take. This is a relationship that this study sought to find out.

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

#### **3.1 Introduction**

This chapter presents a systematic discussion on research strategy to be adopted in establishing the effect of microfinance institutions on financial performance of Small Medium Enterprises. The chapter presents the research methodology under the following subsections; the research design, target population, sampling procedure and sample size, research instruments, validity and reliability, data analysis procedures and ethical considerations.

#### **3.2 Research Design**

The study used a descriptive research design to examine the effect of microfinance services on financial performance of Small Medium Enterprises in Kilifi Town. A descriptive survey was suitable in the study owing to the fact that several Small Medium Enterprises was sampled. A survey design describes people responses to questions about a phenomenon or situation with aim of understanding respondent's perceptions from which truism is constructed (KIM, 2013). This is based on the constructivist epistemology which holds that reality is what respondents generally perceive to be. A survey design was particularly useful as the study sought to establish the perception of respondents in reference to effect of microfinance institutions on financial performance of Small Medium Enterprises.

#### **3.3 Target population**

The target population for this study were microfinance institutions and small and medium enterprises within Kilifi Town in Kilifi County. According to a report on microfinance operations by Cooper, (2012), Kenya has a total of 19 microfinance institutions with some having branches all over the country. For the sake of this study in Kilifi Town, Microfinance

Institutions with nationwide presence and found in Kilifi County were considered. These included; Equity bank, K-rep bank, Faulu Kenya, Small and Micro Enterprise program and Kenya Women Finance Trust. The study targeted the proprietors or managers of the SMEs in Kilifi County who enjoyed services and facilities from the selected MFIs. These totaled to 652.

### **3.4 Sampling Frame**

Sampling of microfinance institutions was based on their distribution within the town. Five microfinance institutions with branches in Kilifi town and elsewhere in the country were selected to participate in the study. Each microfinance institution provided three managers in top management, middle level management and lower level management to participate in the study. This provided a sample size for Microfinance Institutions respondents of 15 whose customers were sampled for the study. The sampling frame for Small Medium Enterprises was drawn from the list of Small Medium Enterprises in Kilifi Town. Stratified random sampling was used to select Small Medium Enterprises to participate in the study. According to Kothari (2004), stratified random sampling entails grouping the study samples into homogenous strata from which a sampling fraction is selected. Small Medium Enterprises within Kilifi town were grouped into various categories based on the listing provided in table 3.2 below. From each strata a sampling fraction of 10% of the target population was selected. Selection of the sample size was based on Kothari (2004) recommendation for sample size which indicate that 10%-20% of the accessible population -is adequate enough for a sample size. This gave sixty six (66) respondents sampled from a population of six hundred and fifty two (652) in the proposed study.

**Table 3.1 Sample population**

<b>Business category</b>	<b>Population</b>	<b>Sampled Size</b>
Enterprises dealing with communication services	50	5
Enterprises dealing with manufactured products	150	15
Enterprises dealing with agricultural produces	250	25
Enterprises dealing with health services	20	2
Enterprises dealing with restaurant and entertainment	120	12
Medium workshops and repair contractors	15	2
ICT service providers	35	4
Small petrol filling stations	12	1
<b>Total</b>	<b>652</b>	<b>66</b>

*Source: Kilifi County Government (2017)*

### **3.5 Data collection instruments**

The researcher used primary data to accomplish the research objectives. Primary data was collected through questionnaires administered to managers in different companies. According to Chandran (2004), questionnaires provide a high degree of data standardization and adoption of generalized information amongst any population. They are useful in a descriptive study where there is need to quickly and easily get information from people in a non-threatening way. They provide flexibility at the creation phase in deciding how questions were administered. Secondary data was gathered through analysis of literature on trends and implications of price controls.

#### **3.5.1 Description of data collection procedure**

Data collection process was commenced by the researcher seeking an introduction letter to carry out research from the university. Further consent was sought from the County of Kilifi with help of a research assistant; the researcher issued the questionnaires to the targeted respondents to fill.

The process was closely monitored so as to clarify any issues that may arise during the answering of the questionnaire. For respondents who were unable to fill the questionnaire at the time the researcher was undertaking the exercise, were given more time so that the researcher picked the questionnaire after two days.

### **3.6 Reliability and validity of Research Instrument**

#### **3.6.1 Reliability of the study**

Reliability was undertaken through a pilot test. According to (Polit, 2001), pilot studies are small scale version[s], or trial run[s], done in preparation for the major study. He further adds that it can be used for pre- testing of a research instrument. Baker (1994) indicates that one advantage of conducting a pilot study is that it might give advance warning about where the main research project could fail, where research protocols may not be followed, or whether proposed methods or instruments are inappropriate or too complicated. The researcher issued questionnaire to one respondent in the microfinance's and each category of Small Medium Enterprises selected. The results of the pilot test and issues emanating from the questionnaire were then used to correct the main questionnaire before actual data collection was undertaken. In order to check reliability of the results, study used Cronbach's alpha methodology, which is based on internal consistency. Cronbach's alpha measures the average of measurable items and its correlation. SPSS software was used to verify the reliability of collected data. Overall scales' reliability of the present situation and the desirable situation was tested by Cronbach's alpha, which was above the acceptable level of 0.70 (Hair et al., 1998). Alpha above the value of 0.7 is considered acceptable (George & Mallery, 2003). The study alpha was 0.7998 which indicated that the research instruments were reliable.

### 3.6.2 Validity of the Research Instrument

Content validity was used to examine whether the questionnaire tests what its intents to test. Validity of the instrument was obtained through the opinion research panel experts in the school of business at Kenyatta University. The opinions of the expert were incorporated in the final questionnaire used to collect data in the field.

Descriptive statistics was used to summarize the data. This included percentages and frequencies. Tables and other graphical presentations were appropriately used to present the data that was collected for ease of understanding and analysis. In addition, the study conducted a multiple regression analysis. The multiple regression equation was;

$$Y = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \varepsilon$$

Where;

Y= financial performance of SMEs in Kilifi County.

B<sub>0</sub> - intercept coefficient

ε<sub>i</sub> - error term (extraneous variables)

X<sub>1</sub> –credit facilities

X<sub>2</sub>– financial literacy

X<sub>3</sub>–managerial skills development

X<sub>4</sub>–market facilitation

β<sub>1</sub>,β<sub>2</sub>, β<sub>3</sub>andβ<sub>4</sub> =regression coefficients

However, qualitative data was analyzed using a likert scale of 1 to 5 based on weights for the degree of influence of independent variables on the dependent where 1 for Not at all, 2 for Low extent, 3 for moderate extent, 4 for greater extent and 5 very greater extent. ANOVA tests were used to analyse the correlation between independent and dependent variables.

### **3.7 Data Analysis techniques and presentation**

Quantitative and qualitative techniques were used to undertake data analysis. Qualitative data analysis involved explanation of information obtained from the empirical literature through open ended questions from the questionnaire. Quantitative analysis involved use of numeric measures in establishing the scores of responses provided. This entails generation of descriptive statistics after data collection, estimation of population parameters from the statistics, and making of inferences based on the statistical findings, with help of Statistical Package for Social Sciences (SPSS).

### **3.8 Ethical considerations**

Permission was sought from the university graduate school in form of an introductory letter to undertake data analysis. Among other ethical considerations are: maintaining confidentiality of respondents participating in this study and the researcher informed the respondents of the purpose and benefits of the study. The respondents equally had the right to withdraw from the study at any point in time.

## **CHAPTER FOUR**

### **RESEARCH FINDINGS AND DISCUSSIONS**

#### **4.1 Introduction**

This chapter focuses on data analysis, results presentation and discussion of the findings. The general objective of this study was to establish the relationship between micro-finance institutions and financial performance of Small Medium Enterprises in Kilifi Town, Kilifi County, Kenya. .

##### **4.1.1 Response rate**

The sample size of this study was 66 respondents out of which 60 filled and returned their questionnaires, which represents a response rate of 90.91%. This correlates with Mugenda and Mugenda (2003) recommendation that a response rate of 50% is adequate for analysis and reporting; a rate of 60% is good and a response rate of 70% and over is excellent. This indicates that the response rate from this study was excellent.

##### **4.1.2 Validity and Reliability Analysis**

To ensure validity, the questionnaire was subjected to a thorough scrutiny by the supervisor whose recommendations and adjustments were incorporated before rolling them out for data collection. In order to determine the reliability of the research instruments, a pretesting was conducted by the researcher. A Cronbach alpha was used to determine reliability where a coefficient of 0.7 or above indicated that the research instruments were reliable. The findings were as tabulated below;

**Table 4.1 Reliability and Validity of the questionnaire**

Variables	No. of items	Cronbach Alpha
Credit facilities	5	0.811
Financial literacy	5	0.788
Development of managerial skills	6	0.795
Market facilitation	5	0.805
Financial performance of SMEs		<b>0.7998</b>

From table 4.2 above, the Cronbach Alpha for credit facilities was 0.811, provision of financial literacy was 0.788, and managerial skills development was at 0.795 while market facilitation was at 0.805. Since all the coefficients of Cronbach Alpha were above 0.7, this indicates that the research instruments were reliable and therefore gave a valid feedback.

## **4.2 Descriptive Statistics**

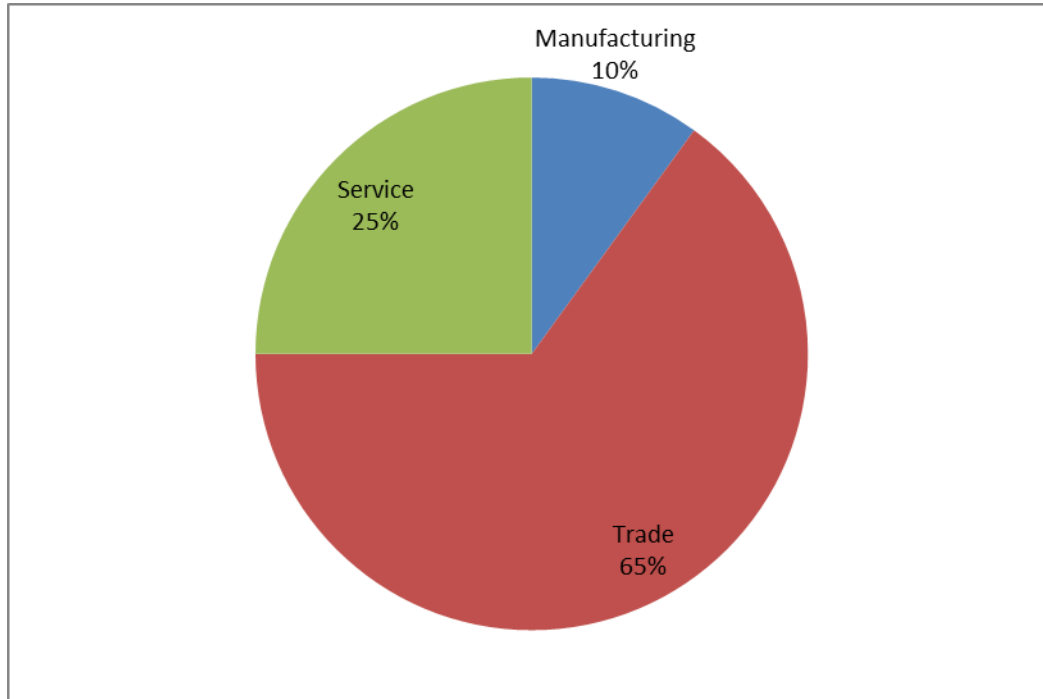
This section presents the general information on the respondents' SME characteristics which comprised of business location, sector, and period in business, current position in the SME, legal formation of the SME and the number of employees within the SME. The responses were presented as follows;

### **4.2.1 Location of Operation**

The respondents were to indicate where they operated their businesses from. 42% of them indicated that they were operating from Kilifi Town Central Business District while 15% were operating from their homes, 21% from industrial areas/Jua Kali shades while 22% were from backstreets or outskirts of the town center. This indicates that there is a fair distribution of the respondents with a majority being from the town.

#### 4.2.2 Business Sector of the Small Medium Enterprises

The respondents were to state the business sector their Small Medium Enterprises belonged to. It was revealed that 65% of the Small Medium Enterprises were from the small-scale trade sector, 25% from service sector while only 10% were from the manufacturing sector. This indicates that majority of the Small Medium Enterprises in Killifi Town belong to the trade sector.

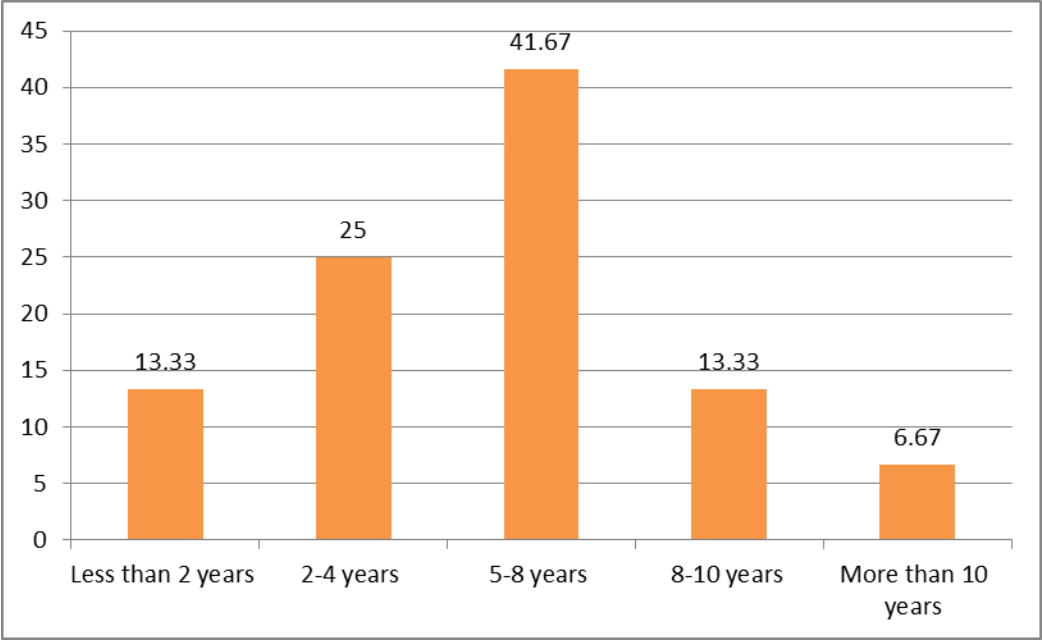


**Figure 4.1 Business sector Small Medium Enterprises are affiliated to**

#### 4.2.3 Period of operation

The study sought to establish how long the Small Medium Enterprises had been in operation.

The findings were as indicated in the figure below;

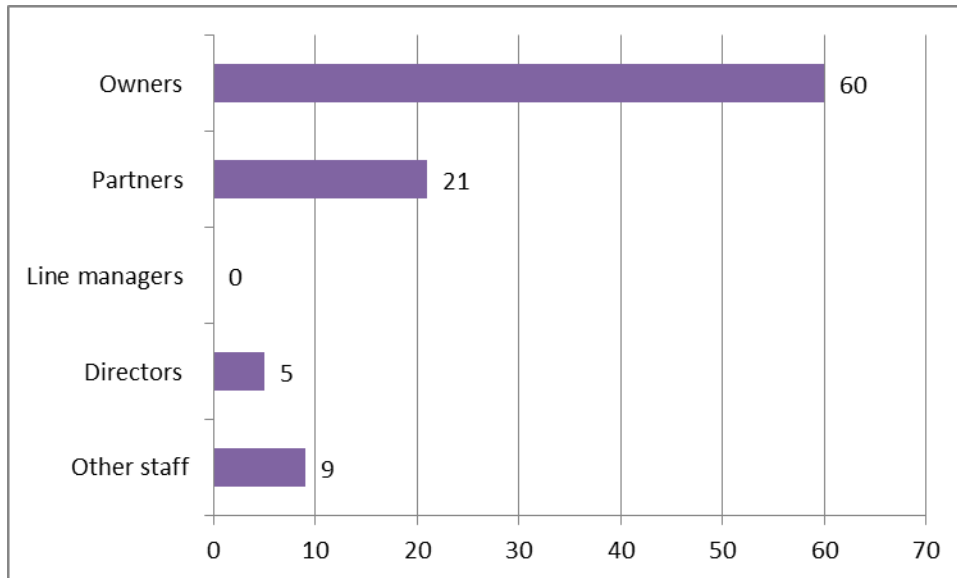


**Figure 4.2 Period of operation**

From the figure above, 13.33% of the Small Medium Enterprises had been in operation for less than 2 years, 25% for between 2 and 4 years, 41.67% for between 5 and 8 years, 13.33% for between 8 to 10 years while a small percentage of 6.67% had been in existence for more than 10 years. This indicates that most Small Medium Enterprises were young and upcoming.

**4.2.4 Current Position in the Business**

The study sought to establish the positions the respondents held in their Small Medium Enterprises. 60% of the respondents indicated that they were owners, 21% were partners, None was a line managers, 5% were directors while 9% were other staff as indicated in the figure below;

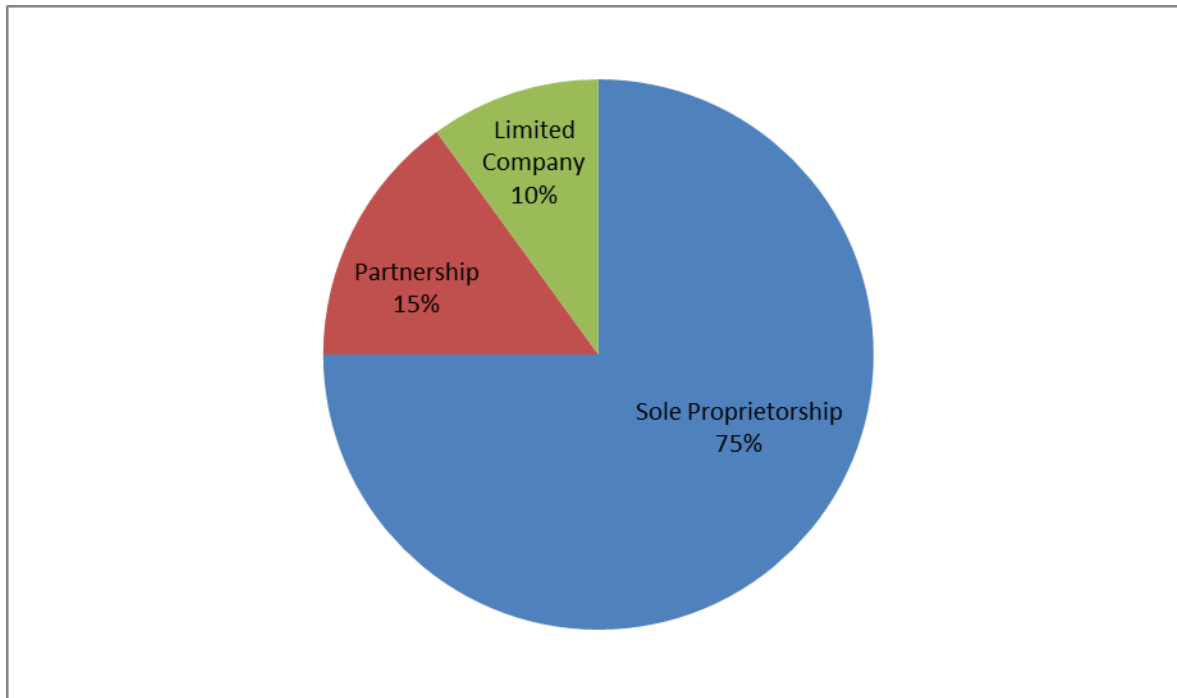


**Figure 4.3 Position held in the Small Medium Enterprises**

From the results above, majority of the respondents were owners of the Small Medium Enterprises at 60% and partners at 21%. This indicates reliability of data to be obtained due to their hands on experience and ownership in the Small Medium Enterprises.

#### **4.2.5 Legal formation of the Small Medium Enterprises**

The respondents were requested to state the form of ownership and formation of the Small Medium Enterprises they emanated from. 75% of the Small Medium Enterprises were sole proprietorship type of businesses, 15% were partnerships while 10% were Limited companies. This indicates that a majority of the Small Medium Enterprises are sole proprietorship kinds of businesses. The figure below presents the findings;



**Figure 4.4 Legal formation of Small Medium Enterprises in Kilifi Town**

#### **4.2.6: Number of Employees**

The study sought to establish the number of employees among the Small Medium Enterprises in Kilifi Town. The findings were presented on a table below;

**Table 4.2 Number of employees among the Small Medium Enterprises**

<b>No. of Employees</b>	<b>Frequency</b>	<b>Percentage</b>
Below 5	31	51.67
6 -10	15	25.0
11-20	8	13.33
21-50	4	6.67
Over 50	2	3.33
<b>Total</b>	<b>60</b>	<b>100</b>

From Table 4.1 above, 51.67% of them had less than 5 employees, 25% of the Small Medium Enterprises had between 6 to 10 employees. 13.33% had between 11-20 employees, 6.67% of

them had between 21-50 employees while only 3.33% had over 50 employees. This indicates that more than half of the Small Medium Enterprises had less than 5 employees. This indicates that most Small Medium Enterprises are small scale and therefore need MicroFinance Institutions to boost them in terms of literacy and finances to grow.

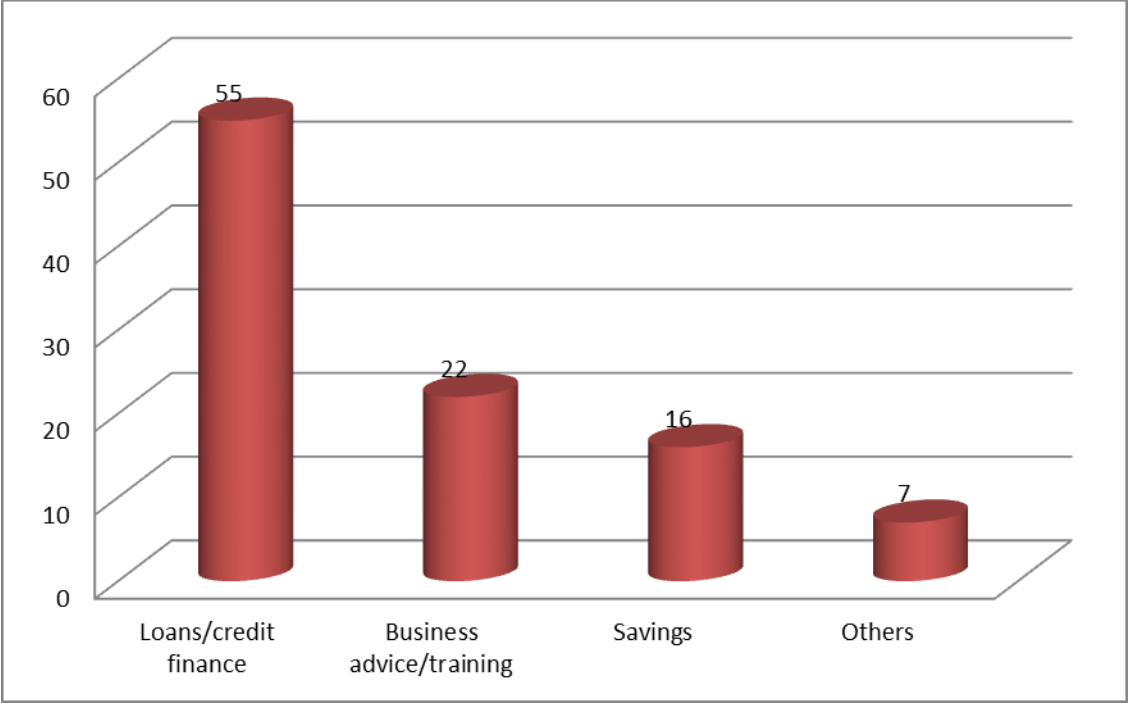
### **4.3 Microfinance Institutions Financing Services**

#### **4.3.1 Microfinance Institutions and Services Awareness**

The respondents were to indicate whether they were aware of the existence of microfinance institutions and the services they offered to Small Medium Enterprises in Kilifi Town. 95% of the respondent were aware of the existence of microfinance Institutions and some of the services they offered while 5% were not well versed with the existence and even the services due to their coming from outskirts of the town and some operating from home hence lacking information.

#### **4.3.2 Services Received from Microfinance Institutions**

The respondents were to indicate the services they had received from microfinance institutions. The findings were shows that 55% of the Small Medium Enterprises have get credit/loan financing from the Small Medium Enterprises, 22% get business advice/training from the Microfinance Institutions, 16% of the Small Medium Enterprises save with them, while 7% of them get other services like Insurance, deposits and investment opportunities like purchasing land, housing etc.



**Figure 4:5 Services Small Medium Enterprises get from Small Medium Enterprises**

The microfinance Institutions need to collaborate with Small Medium Enterprises in enhancing their growth by providing business advice and training before extending credit especially to those in remote areas of Kilifi Town. Microfinance Institutions need to diversify their services and involve Small Medium Enterprises in their activities through flexibility in credit extension by making the terms and conditions favorable especially to small and emerging Small Medium Enterprises. Embracing product and service innovation to take advantage of economies of scale and also reach more Small Medium Enterprises

**4.4 Development of Management Skills**

The respondents were to rate how the following skills have been impacted by the trainings offered by Microfinance Institutions on a Likert scale of 1 to 5 where 1 =very small extent; 2=small extent; 3= moderate; 4=large extent and 5=very large extent. The findings were as tabulated below;

**Table 4.3 Extent of application of Development of Management Skills**

<b>Statement</b>	<b>Mean</b>	<b>SDEV</b>
Basic business skills	3.85	0.771
Capital investment decisions	3.08	0.681
Business risk management	2.53	0.927
Trainings enable the SMEs to become economic agents of change by increasing their income, productivity and decision making power	3.53	0.811
Enhances development of sustainable community and social service skills like financial literacy	2.93	1.245

From table 4.2 above, the trainings offered by the microfinance institutions to the Small Medium Enterprises have to a great extent imparted basic business skills to the owners and proprietors of Small Medium Enterprises at a mean of 3.85 and the trainings enable them to become economic agents of change by increasing their income, productivity and decision making power as indicated by a mean of 3.53. To a moderate extent do the trainings offered by microfinance institutions improve their business risk management skills, capital investment decisions and enhance development of sustainable community and social service skills like financial literacy at a mean of 2.93. Other trainings were on insurance services significance and products thereof. The same findings were obtained by Mugure (2015) among small scale educational institutions and how capacity building improves performance among managers.

#### **4.5 Financial Literacy**

The study sought to analyze the extent of application in respect to financial literacy by Microfinance Institutions on a scale of 1 to 5; 1 =Less favorable; 2=moderately satisfactory;3=satisfactory;4=Very satisfactory and 5=Most satisfactory. The findings were as tabulated below;

**Table 4.4 Extent of application of financial literacy services**

<b>Statement</b>	<b>Mean</b>	<b>SDEV</b>
The microfinance institutions financial literacy is adequate	2.42	0.766
Microfinance institutions financial literacy services are easily accessible	2.40	1.554
Financial literacy is done bimonthly	2.33	0.899
There are easy learning procedures	2.42	0.682
The financial literacy have increased the amount of capital available for production and expansion of SMEs	2.18	1.108

From the table above the mean for all the indicators for financial literacy trainings by microfinance institutions to Small Medium Enterprises is above 2 and less than 3. This indicates that the trainings are moderately satisfactory but are not therefore sufficient and effective for the Small Medium Enterprises in Kilifi Town. The Financial Sector Deepening Report (2013) by FDS also indicated that low financial literacy by SMEs has negatively affected their management of resources especially those borrowed leading to failure to grow.

#### **4.6 Market Facilitation**

Market facilitation is a type of market intervention, agent or action, which works to stimulate markets while still remaining outside of the market themselves. This approach targets relationships, ownership, incentives, light touch intervention and continuous exit strategy, The respondents were to rate the impact of market facilitation by microfinance institutions on the performance of SMEs in Kilifi Town on a likert scale of 1 to 5; where 1 =very small extent; 2=small extent; 3= moderate; 4=large extent and 5=very large extent. The findings were as indicated below;

**Table 4.5 Impact of Market Facilitation by Microfinance Institutions on Performance of Small Medium Enterprises**

<b>Statement</b>	<b>Mean</b>	<b>SDEV</b>
Microfinance institutions have contributed in fuelling growth of my enterprise	2.48	0.771
My enterprise has been stable and growing without MFIs contributions	2.30	0.801
It has led to expansion of new markets	2.38	1.620
The savings enable SMEs to make a greater contribution to new markets	2.55	0.869

From table 4.4, it is evident that Microfinance Institutions have not done much on market facilitation for the Small Medium Enterprises as indicated by a mean of less than 3. This indicates that their impact has been to a small extent. A lot however needs to be done by Microfinance Institutions through collaborations on giving incentives, technological innovations to improve service delivery and ease of doing business for the Small Medium Enterprises, strategic entry and exit and ownership. Above all, for the Small Medium Enterprises to get market for their goods and services the microfinance institutions need to cultivate a good relationship with them to establish market connections and network as indicated by Mwangi (2013).

#### 4.7 Small Medium Enterprises Financial Performance

This was aimed at indicating the performance of the firms over the 5 year period to inform the influence of the microfinance institutions services on their performance over time. The table below indicates the average percentage outcome for each year for all the respondents;

**Table 4.6 Small Medium Enterprises Financial Performance**

	2015	2014	2013	2012	2011	
<b>Financial Performance Indicators</b>	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>	<b>Average %</b>
Percentage annual growth in sales	72	60	51	42	35	52
Amount of microloan received as a percentage of net assets	27	23	20	18	15	20.6
Amount of saving mobilized through Microfinance Institutions as a percentage of net assets	48	37	29	19	12	29
Number of training offered	34	27	24	15	5	21

From the table above, annual growth in sales has been significant over the 5 year period considered at 52% while the rest of the indicators on loans, savings and trainings offered have been below average which shows that there are other factors that influence performance of Small Medium Enterprises a part from microfinance institutions services informing the growth in sales. However, to assess the financial performance of Small Medium Enterprises further, the respondents were to rate their Small Medium Enterprises performance on a Likert Scale of 1 to 5 where 1 =very small extent; 2=small extent; 3= moderate; 4=large extent and 5=very large extent. The findings were as tabulated below;

**Table 4.7 Over Financial Performance of Small Medium Enterprises**

<b>Overall financial performance of SMEs</b>	<b>Mean</b>	<b>SDEV</b>
Access to loan services contribution to your SME performance	2.78	0.668
Access to training contribution to your SME financial performance	2.53	0.711
Access to savings contributed to your SME financial performance	3.03	0.982

The table indicates that access to loan services offered by microfinance institutions, training and savings contributes to a moderate extent to the financial performance of Small Medium Enterprises at a mean of 3. This implies that the microfinance institutions services have not been fully extended to the Small Medium Enterprises to turn around their profitability and hence financial performance.

90% of the Small Medium Enterprises however indicated that the services extended to them by microfinance institutions contributed positively to the financial performance of their businesses while 4% indicated a negative effect and 6% indicated no effect. This shows that the microfinance institutions services have an impact on performance but they need to be accessible, affordable, effective and efficient in terms of timeliness of credit and other services. The Microfinance Institutions also need to train the traders before extending loans to them to avoid misuse of the funds.

#### **4.8 Regression Analysis**

The researcher conducted multiple regression analysis to establish the influence of credit facilities, provision of financial literacy training, development of managerial skills and market facilitation on financial performance of SMEs in Kilifi Town, Kilifi County, Kenya. The findings were as indicated in subsequent sections;

**Table 4.8 Model Summary**

<b>Model</b>	<b>R</b>	<b>R Square</b>	<b>Adjusted R Square</b>	<b>Std. Error of the Estimate</b>
<b>1</b>	0.992	0.897	0.814	0.578

The table above indicates the model summary. From the findings, R was 0.992, R square was 0.897 and adjusted R squared was 0.814. An R square of 0.897 implies that 89.7% of changes in financial performance of SMEs in Kilifi Town are explained by the independent variables of the study. There are however other factors that influence financial performance of SMEs that are not included in the model which account for 10.3%. An R of 0.992 on the other hand signifies strong positive correlation between the variables of the study.

**Table 4.9 ANOVA**

<b>Model</b>	<b>SS</b>	<b>df</b>	<b>MS</b>	<b>F</b>	<b>Significance</b>
Regression	575.44	5	358.5	476.564	0.0876
Residual	311.10	475	0.588		
<b>Total</b>	<b>886.54</b>	<b>480</b>			

From the ANOVA table above, the value of F calculated is 476.244 while F critical is 361.521. Since the value of F calculated is greater than F critical, the overall regression model was significant and therefore a reliable indicator of the study findings. In terms of p values, the study indicated 0.0242 which is less than 0.05 and therefore statistically significant.

**Table 4.10 Regression Coefficients**

Model	Unstandardized coefficients		Standardized Coefficients	T	Sig
	B	Std Error	Beta		
Constant	2.553	0.807		2.296	0.000
Credit facilities	0.812	0.033	0.864	12.14	0.000
Financial literacy	0.622	0.036	0.124	09.52	0.000
Development of managerial skills	0.755	0.045	0.045	1.24	0.000
Market facilitation	0.624	0.0352	0.127	5.33	0.000

The resultant regression equation becomes;

$$Y = 2.553 + 0.812X_1 + 0.622X_2 + 0.755X_3 + 0.624X_4$$

Where Y is the financial performance of SMEs in Kilifi Town, Kilifi County;  $\beta_0$ ,  $\beta_1$ ,  $\beta_2$ ,  $\beta_3$  and  $\beta_4$  are the regression coefficients and  $X_1$ ,  $X_2$ ,  $X_3$  and  $X_4$  represent credit facilities, financial literacy, managerial skills development and market facilitation respectively.

This implies that when all the variables of the study are held constant, financial performance of SMEs in Kilifi Town, Kilifi County, Kenya will be at the intercept of 2.553. A unit improvement in SME financing while all other factors held constant results in 0.812 increase in financial performance of SMEs, a unit increase in financial literacy training with other factors ceteris paribus, leads to 0.622 increase in financial performance of SMEs. Similarly a unit increase in development of managerial skills and market facilitation while other factors held constant, translates to a 0.755 and 0.624 increase in the financial performance of SMEs. This correlates to findings by Ngechu (2010) on a study on the MFI role on growth of SMEs.

## **CHAPTER FIVE**

### **SUMMARY, CONCLUSIONS AND RECOMMENDATIONS**

#### **5.1 Introduction**

This chapter contains the summary of findings, conclusions and recommendation according to the research objectives.

#### **5.2 Summary**

The general objective of the study was to establish the effects of Microfinance Institutions Services on the financial performance of Small Medium Enterprises in Kilifi Town, Kilifi County, Kenya. The study was guided by the following specific objectives; to establish the effect of credit facilities, financial literacy, development of managerial skills and market facilitation on financial performance of small and medium enterprises in Kilifi Town. The sample for the study included the 66 owners, directors or partners of the Small Medium Enterprises but the researcher managed to get 60 complete questionnaires which were used in analyzing the data. Descriptive research design was used to establish the influence of the four independent variables on the dependent variable.

75% of the Small Medium Enterprises were sole proprietorship type of businesses and had none or few employees. This indicates that the Small Medium Enterprises in Kilifi Town are small scale in nature. 95% of the respondent were aware of the existence of microfinance institutions and some of the services they offered while 5% were not well versed with the existence and even the services due to their coming from outskirts of the town and some operating from home hence lacking information. The trainings offered by the microfinance institutions to the Small Medium Enterprises have to a great extent imparted basic business skills to the owners and proprietors of Small Medium Enterprises and the trainings enable them to become economic agents of change

by increasing their income, productivity and decision making power. To a moderate extent do the trainings offered by microfinance institutions improve their business risk management skills, capital investment decisions and enhance development of sustainable community and social service skills like financial literacy. Other trainings were on insurance services significance and products thereof.

It is revealed that microfinance institutions have not done much on market facilitation for the Small Medium Enterprises as indicated by the mean of less than 3. Annual growth in sales have been increasing significantly over the 5 year period considered at 52% while the rest of the indicators on loans, savings and trainings offered have been below average which shows that there are other factors that influence performance of Small Medium Enterprises a part from microfinance institutions services informing the growth in sales. However, the microfinance institutions services have not been fully extended to the Small Medium Enterprises to turn around their profitability and hence financial performance.

90% of the Small Medium Enterprises however indicated that the services extended to them by microfinance institutions contributed positively to the financial performance of their businesses while 4% indicated a negative effect and 6% indicated no effect. This shows that the microfinance institutions services have an impact on performance but they need to be accessible, affordable, effective and efficient in terms of timeliness of credit and other services. The microfinance institutions also need to train the traders before extending loans to them to avoid misuse of the funds.

From the regression coefficients, the selected microfinance services by the MFIs in Kilifi County have a positive and significant influence on the financial performance of SMEs.

### **5.3 Conclusion**

The study concludes that there a number of significant number of Small Medium Enterprises in Kilifi Town, Kilifi County. The Small Medium Enterprises are significantly aware of the services offered by the microfinance institutions.

The study concluded that the microfinance institutions have not done much in ensuring that their services reach and are appreciated by Small Medium Enterprises in the town. The study also concluded that credit facilities and financial literacy have significantly been extended to the Small Medium Enterprises by the microfinance institutions but development of managerial skills and market facilitation have not been done to expectations.

### **5.4 Recommendations**

The study recommends that microfinance institutions in Kilifi Town need to sensitize Small Medium Enterprises on uptake and significance of their services. Credit facilities by microfinance institutions extended to Small Medium Enterprises need to be done after sufficient financial and business management skills have been given to the recipients. This will limit financial mismanagement, loan loss and delinquency and subsequent closure of the enterprises. The MFIs should enhance financial literacy trainings and managerial skills development to ensure the SMEs are well managed and finances well utilized. Market networks developed by MFIs to aid SMEs get market for their products and services should be done in consultation with the SMEs to ensure the right price and market niche is identified.

### **5.5 Suggestions for Further Research**

During the literature review, data collection and analysis, the researcher felt that some of the issues required further research as the scope and limitations of this research could not permit

their study. Further research needs to be done to establish the influence of business skills on the financial performance of Small Medium Enterprises, the factors hindering financial literacy services by microfinance institutions to Small Medium Enterprises and the relationship between credit facilities offered by MFIs and their performance

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## APPENDICES

### APPENDIX I: INTRODUCTION LETTER

JACINTA ISMAIL

Kenyatta University,

P.O. Box 702 – 60100,

NAIROBI.

#### **RE: Request to fill in the Questionnaire**

Dear Respondent,

I am a graduate student at Kenyatta University, carrying out research project. This is in partial fulfillment of the requirement of the Master of Business Administration degree program at the Kenya University.

You have been randomly selected among many to participate in this study. It is estimated that it will take less than twenty (20) minutes of your time to complete the questionnaire. Please respond as honestly and objectively as possible. Your participation is very essential for the accomplishment of this study and it will be highly appreciated. I guarantee that the information that you will provide will be treated with the utmost confidentiality and will be used only for academic purposes.

This is an academic research and confidentiality is strictly emphasized, your name will not appear anywhere in the report. Kindly spare some time to complete the questionnaire attached.

Thank you.

Yours faithfully,

Jacinta ismail

## APPENDIX II: QUESTIONNAIRE

### SECTION A: BACKGROUND INFORMATION

1. Please indicate the location from which you operate .....
2. Which business sector does your Small Medium Enterprises business belongs to?

- a) Manufacturing ( )
- b) Trade ( )
- c) Service ( )

3. For how long has your firm been in operation?

- a) Less than 2 years ( )
- b) 2–4 years ( )
- c) 5-8 years ( )
- d) 8-10 years ( )
- e) More than 10 years ( )

Please specify the exact years as at December 2015.....

4. What is your current position in the business?

- a) Owner ( )
- b) Partner ( )
- c) Line Manager ( )
- d) Director ( )
- e) Other Staff ( )

5. What is the legal formation of the Small Medium Enterprises?

- a) Sole proprietorship ( )
- b) Partnership ( )
- c) Limited company ( )

6. What is the current Small Medium Enterprises number of employees

- a) Below 5 ( )
- b) 6-10 ( )
- c) 11-20 ( )
- d) 21-50 ( )
- e) Over 50 ( )

**SECTION B: MICROFINANCE INSTITUTIONS FINANCING SERVICES**

7. Are you aware of the existence of Microfinance Institutions and the services they offer to Small Medium Enterprises?

Yes ( ) No ( )

I no please specify why

.....

Which of the following services does your firm receive from microfinance institutions:

- a) Loans/credit finance ( )
- b) Business advice/trainings ( )
- c) Savings ( )
- d) Others ( )

If others, please list them

.....

8. In your view, what do you recommend should be done to enhance the growth and development of financing services to Small Medium Enterprises in Kilifi County?

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

**SECTION C: DEVELOPMENT OF MANAGEMENT SKILLS**

9. In a scale of 1-5, rate how the following skills have been impacted by the trainings offered any by Microfinance Institutions. Note 1 =very small extent; 2=small extent; 3= moderate ;4=large extent and 5=very large extent

Statement	1	2	3	4	5
Basic business skills					
Capital investment decisions					
Business risk management					
Trainings enable the Small Medium Enterprises to become economic agents of change by increasing their income, productivity and decision making power					
Enhances development of sustainable community and social service skills like financial literacy					

Other skills.... (Please specify)

**10.** In your view, what do you recommend should be done to enhance the growth and development of managerial skills of Small Medium Enterprises in Kilifi County?

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

**SECTION D: FINANCIAL LITERACY**

**11.** In a scale of 1-5, rate the below in respect to financial literacy by Microfinance Institutions.

Note 1 =Less favorable; 2=moderately satisfactory;3= satisfactory;4=Very satisfactory and 5=Most satisfactory

<b>Statement</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
The Microfinance Institutions financial literacy is adequate					
Microfinance Institutions financial literacy services are easily accessible					
Financial literacy is done bimonthly					
There are easy learning procedures					
The financial literacy have increased the amount of capital available for production and expansion of the Small Medium Enterprises					

**12.** In your view, what do you recommend should be done to enhance the growth and development of financial literacy of Small Medium Enterprises in Kilifi County?

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

**SECTION D: MARKET FACILITATION**

**13.** In a scale of 1-5, rate the below impacts of market facilitation by Microfinance Institutions.

Note 1 =very small extent; 2=small extent; 3= moderate; 4=large extent and 5=very large extent.

<b>Statement</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
Microfinance Institutions have contributed in fuelling growth of my Enterprise					
Microfinance Institutions have contributed in fuelling stability of my Enterprise					
My Enterprises has been stable and growing without Microfinance Institutions contributions					
It has led to expansion of new markets					
The savings enable Small Medium Enterprises to make a greater contribution to new markets					

**14.** In your view, what do you recommend should be done to enhance the financial performance of market facilitation of Small Medium Enterprises in Kilifi County?

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

**SECTION E: SMALL MEDIUM ENTERPRISES FINANCIAL PEFROMANCE**

**15.** Please indicate the following in relation to your firm as in the below table.

<b>Year</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>
	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>
Percentage annual growth in sales					
Amount of microloan received as a percentage of net assets					
Amount of saving mobilized through Microfinance Institutions as a percentage of net assets					

Number of training offered					
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**16.** How would you rate your Small Medium Enterprises financial performance?  
 Note 1 =very small extent; 2=small extent; 3= moderate; 4=large extent and  
 5=very large extent

Status	1	2	3	4	5
Financial performance					

**17.** In a scale of 1-5, rate the below the extent that Microfinance Institutions Services have contributed to your financial performance. Note 1 =very small extent; 2=small extent; 3= moderate; 4=large extent and 5=very large extent

Statement	1	2	3	4	5
Access to loan services contribution to your Small Medium Enterprises financial performance.					
Access to training contribution to your Small Medium Enterprises financial performance.					
Access to savings contributed to your Small Medium Enterprises financial performance.					

**18.** In your own opinion, what is the overall effect of microfinance institutions services on the financial performance of Small Medium Enterprises?

- a) Positive effect ( )
- b) Negative effect ( )
- c) No effect at all ( )

**19.** In your view, what do you recommend should be done to enhance the growth and development of financial performance of Small Medium Enterprises in Kilifi County?

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