

**DETERMINANTS OF FINANCIAL PERFORMANCE OF MICRO FINANCE
INSTITUTIONS IN NAIROBI COUNTY, KENYA**

By

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DECLARATION

I declare that this dissertation is my original work and has not been previously published or submitted elsewhere for award of a degree. I also declare that this contains no material written or published by other people except where due reference is made and author duly acknowledged.

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I do hereby confirm that I have examined the master’s dissertation of

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And have certified that all revisions that the dissertation panel and examiners recommended have been adequately addressed.

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DETERMINANTS OF FINANCIAL PERFORMANCE OF MICRO FINANCE INSTITUTIONS IN NAIROBI COUNTY, KENYA

ABSTRACT

Microfinance programmes are one of the most important interventions in developing nation's efforts to reduce poverty. Recent years have seen slow growth of the sector in terms of numbers and size of organizations, number of clients and provision of subsidized donor funding. The Kenyan microfinance sector has evolved over time to become commercialized, self-sustaining and hugely profitable institutions. Microfinance is also rapidly becoming Kenya's most accessible and affordable financial service. There has been extensive research carried out on the growth of microcredit lending and the subsidized loan lending by non-governmental organizations (NGOs) in Kenya. However, there is little understanding of the factors constraining the financial performance of micro finance institutions MFIs other than competition from commercial banks. This research study was conducted in order to identify specific constraints to the financial performance of microfinance institutions in Nairobi County, Kenya. The study was guided by the following objectives: to identify the main constraints to financial performance of microfinance institutions in Nairobi County, to determine the effects of cost of operations, client drop-outs, clients loan default rates and fraud cases on the financial performance of microfinance institutions in Nairobi County. The study adopted a descriptive survey research design to study the factors constraining the financial growth of the MFIs. A census of all the 59 MFIs registered with the Association of Microfinance Institutions of Kenya AMFI (found on AMFI website) was carried out. The (unit of analysis) informants for the study were drawn from the senior employees (general managers) of MFIs. Data was collected using questionnaires. Data obtained was analyzed using both inferential statistics-Multiple regression and descriptive statistics by use of graphs and pie charts. From the findings MFIs in Kenya still face major constraints to efficiently and effectively deliver microfinance services in the country. As the demand for MFIs services continues to grow, the sector faces many constraints, from the findings of this study based on regression results: operational costs, client loan defaults and Client drop-out had a negative and significant relationship with financial performance of MFIs while fraud cases among the MFIs were found to have a negative but not significant impact on the performance of MFIs. The way forward in tackling the constraints to MFIs growth include :MFIs to increase operational efficiency and increase innovations in the products offered, convert into deposit taking microfinance as this will enable them mobilize cheap savings from depositors instead of taking loans from commercial banks which are expensive, stop relying on donors contributions and borrow directly from financial markets. The government to come up with friendly policies that favors growth of microfinance sector e.g tax holidays or lower tax rates in marginalized areas. To reduce cases of loan default among clients the MFIs should have access to credit reference bureaus to confirm clients' credit history before giving out loans to avoid cases of multiple borrowing. To reduce fraud MFIs should embrace concept of risk management by continuously training their staff, acquire and use latest technology in their daily operations and have internal audit report directly to the board and not senior management.

Keywords: microfinance institutions, loan default, clients' dropout, operational costs and fraud.

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DEDICATION

I dedicate this work to all my colleagues for their invaluable support and encouragement

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ACRONYMS AND ABBREVIATIONS

AMFI	Association of Microfinance Institutions of Kenya
DFID	Department for International Development
FSD	Financial Sector Deepening Kenya
KWFT	Kenya Women Finance Trust
MFI s	Microfinance Institutions
MIS	Management Information System
NGOs	Non-Governmental Organizations
SMEs	Small Medium Enterprises
USAID	United States Aid

DEFINITION OF TERMS

Microfinance- is defined as the provision of a range of financial services that include; microcredit, micro savings and micro insurance, to poor people and small and medium enterprises (Mwaniki, 2006)

Sustainability-is defined as the measure of the MFI program efficiency, i.e. it is the ratio between inputs and outputs. The greater the level of outputs for a given level of inputs, the greater should be the level of efficiency according to K'Aol & Ochanda. (2012}.

Outreach refers to the number of clients served by a microfinance institution at a given time Mulunga (2010).

MFIs client drop out refers to the number of clients leaving the program due to competition or dissatisfaction with the services offered. Stark and Nyirumuringa (2002),

MFIs loan default-refers to the actual total amount of loans not repaid on time and or completely not repaid at all by the client Bichange and Aseyo (2013)

MFIs operational costs refers to both transaction and administration costs of loan processing which are generally higher compared to the returns (interest income) earned from the loans advanced,. Tulchin (2004)

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

The microfinance landscape in Kenya is very different from that of countries such as India and Bangladesh, which have seen enormous growth in their MFI sectors. (Financial Sector Deepening Kenya review 2012). Microfinance in Kenya has not grown to the extent seen in these Asian countries for several reasons. One of the challenges that MFIs face is a lack of population density, that is most of the population lives in rural, sometimes very remote areas. This creates a challenge in reaching large numbers of clients efficiently and makes it more difficult for MFIs to reach large scale; MFI penetration is still extremely low outside of cities in Kenya. The majority of people living in rural areas have absolutely less access to formal financial services compared to those who live in cities.

In spite of a significant part played by MFIs in providing a broad range of financial products and services to the poor, many microfinance institutions still face numerous constraints to efficiently and effectively deliver microfinance services. Even with the ever increasing demand for these financial services, the available scarce sources of capital have greatly undermined the ability of MFIs to efficiently operate their services and expand their various microfinance services. This has led to a financial gap in the supply of microfinance services, and consequently reduced the opportunities for the poor to access basic benefits that could improve their live hoods. Matu (2008) notes that the widening financial gap in the microfinance sector has been due to internal-governance issues, general capacity building, non-compliance with legal and regulatory requirements and a lack of standard performance criteria. These factors have constrained microfinance sustainability and compromised the delivery of microfinance services

to the poor people. He recommends for the need to have a policy that advocates for better access to capital sources and investment opportunities for microfinance sustainability, and also encourages MFIs to increase their accessibility, build capacity, be more transparent, adopt acceptable performance standards, and promote professionalism to enhance service delivery

Njagi (2011) noted key reasons as to the low MFIs financial performance included: limited financial resources, loan defaults by recipients, poor management information systems and poor research& development departments. MFIs can boost performance level by improving on marketing, research and development, adoption of policies that increase their working capital.

Recovery of Nonperforming loans through the legal process is another challenge for micro finance institutions. Most of the MFIs continually face challenges while enforcing loan repayments from clients and capable loan defaulters. The loan recovery process through the legal channels tends to be fruitless venture as little gains made. Even for larger size loans, microfinance institutions prefer to use other means of bad loans recovery rather than the legal channel because of fear of loss of time and money (Mwaniki, 2006).

Interest rates charged by microfinance institutions still remain higher than commercial banks not because of predatory practices but due to associated servicing costs are much higher for small loan and the type of MFI. (Julien 2009) reported that despite their high interest rates micro loans remain the best choice to the poor who would otherwise opt to borrow from informal money lenders and shylocks who levy very high interest rates. The best way for microfinance to lower interest rates is through increasing the operational efficiency, raise levels of innovations in the financial products and services offered and upgrade the technology used to service and offer loans to the poor people

Over indebtedness of MFIs clients in certain sectors possess a great challenge to MFIs survival. This poses a moral risk to both the MFIs clients and the microfinance institution, the latter does not adequately evaluate the risk level of the client and this can be an external threat to the idea of microfinance. Shumphre (2013) noted that high funding costs to microfinance institutions is another external constraint to microfinance institutions. High funding costs are sometimes transferred to MFIs clients in form of high interest charged depending on the type of credit and conditions.

Hogarth (2009) notes that in competition for MFIs clients, commercial banks have an upper hand as they are able to identify very best MFIs clients and poach them by offering very attractive financial products with better terms and conditions compared to MFIs. In competition with commercial banks, MFIs are disadvantaged because they heavily depend on funds from the same commercial banks they are competing with and have to increase their interest rates when lending to their clients to cover their financing costs. MFIs loan products terms and conditions are also too involving when compared to commercial banks which may offer flexible terms and extended repayment schedules. Finally commercial banks are accused of capitalizing on insider information when lending to MFIs and later use this information to poach their best clients

1.1.1 History of microfinance

The present microfinance movement traces its roots back in Bangladesh in the mid-1970s, Muhammad Yunus, gave out small, no-collateral loans to groups of poor borrowers who were unable to get credit from commercial banks. Three decades down the line, his model became widely recognized and replicated in other countries to enable the poor access credit and fight poverty (Credit Kenya report 2011).

Initially Yunus tried to extend his idea to other bankers in Bangladesh, but they were afraid that it was too risky as a business and turned down the offer, but with the help of donors and the government he founded Grameen Bank. Grameen Bank is now one of the world's largest micro finance institutions with over 4 million lenders. By the 1990's lenders had learned how to increase loan repayment rates enough to make micro finance institutions sustainable which was achieved through group lending. They targeted women as borrowers and gave them money to invest in businesses that would increase their income and charged very low interest rates so the borrowers could pay back their loans and still have money, i.e. create wealth, for themselves. This is when the term micro finance was coined to replace micro credit, because the new institutions were doing more than making loans; they were offering other financial services to the poor like savings accounts, insurance and money transfers (Lindsay 2010).

Banks are also increasingly joining the micro finance market hence causing the sector to be more commercialized. The first commercial microfinance institution was founded in Bolivia in 1992. The founders of this commercial MFI were originally the founders of a nonprofit MFI in 1986 called PRODEM. PRODEM grew so rapidly that after 2 years, it had more people desiring loans than they could support. They then created BancoSol to meet the growing needs of the borrowers in Bolivia and became the first ever MFI to issue dividends. Nonprofit micro finance institutions are successful, but reach a lower capacity of lending when they run out of donations. The trend now is shifting away from donor supported micro finance institutions towards investing in commercial viable micro finance institutions (Lindsay, 2010).

The increasing competition among lenders Commercial banks and MFIs themselves over the years and a weak global economy have strained borrowers and microfinance institutions alike. As an increasing number of banks and for-profit companies entered the market and

contributions from investors increased, some markets became over-saturated and borrowers over-extended. Microfinance institutions are now seeking ways to expand their growth with less risks but greater returns (Credit Kenya report 2011).

Microfinance was once associated almost exclusively with small-value loans to the poor, today are increasingly used to refer to a broad array of products which include: small or microloans, savings, and insurance designed to meet the particular needs of low-income groups. Poor people, like everyone else, need a diverse range of financial services to run their businesses, build assets, smooth consumption, and manage risks. A growing body of empirical evidence shows that access to the right financial service at the right time helps households build assets, generate income, smooth consumption, and protect themselves from risks. At the policy level, decision-makers have recognized that an inclusive financial system that reaches all citizens also allows for more effective and efficient execution of other social policies, for example through conditional payment transfers in health and education. And at the macro level, we know that deeper financial intermediation in an economy leads to more growth, and less inequality

According to (Udejaja & Ibe 2011) an MFI that succeeds in recovering all of its operating expenses is said to have reached operational self-sufficiency (OSS) and when the MFI is able to recover all of its operating costs, and make profit it is said to have reached financial self-sufficiency (FSS). The OSS and FSS are the necessary and sufficient conditions for institutional viability. Organizations that have attained institutional viability see interest and fees as the main source of operating income. Interest rates are important to sustainability, and their rates compete with those from informal finance. Viable MFIs (VMFIs) are those MFIs that have attained both OSS and FSS. A VMFI can access commercial funding that could enable it expand its portfolio

and reach more poor people. The goal of microfinance today is to provide financial services to the poor on a sustainable basis, which could only be possible through the existence of VMFIs

In the past 25 years, the delivery of financial services to the poor population has been considered as an important anti-poverty reduction tool. Micro finance may not be a cure for poverty and related development challenges, it has and continues to play an important role in the following key areas: helping to reduce unemployment, thereby increasing poor peoples' incomes and consumption; women have been empowered and given a livelihood and independence. Significant amounts of savings have been mobilized and in process leading to a savings culture development among the poor population. Further, micro finance has enabled poor people to access better health, education and nutrition (Mwaniki, 2006)

Microfinance has nowadays emerged as a growing industry to provide financial services to very poor people. Before then, microfinance focused mainly on providing microcredit to micro businesses. Today, there is a growing recognition that poor people need a variety of financial services, not just credit. (Mwaniki, 2006) Current microfinance has therefore moved towards providing a range of financial services, including microcredit, micro savings and micro insurance, to poor people and small and medium enterprises worldwide.

Historically, the main goal of microfinance in Kenya was the alleviation of poverty. Alleviation of poverty was the primary social objective and so traditional microfinance institutions consisted of only of NGOs, specialized microfinance banks and public sector banks (Kaburi, Ombasa, Omato, and Mobegi & Memba. 2013). In developing countries it is worth noting that in the recent times the market place has been evolving such that the traditional microfinance institutions have and are transforming themselves into profit seeking institutions. The argument attributed to this is that they want to achieve greater strength, sustainability and

market rich. Although most microfinance institutions consider alleviation of poverty their primary goal, experimenting with new techniques and strategies to raise more incomes and create jobs in order to sell more products to more consumers is also a motivation to many new entrants.

For microfinance to fully realize its potential to fight poverty, MFIs and donors supporting microfinance institutions must explicitly adopt a strategy that aims to have social impacts such as reducing poverty, and measures progress towards achieving them, as well as having strong financial strategies and controls. ‘Most MFIs have explicit social goals within their mission statements, but these are rarely seen as part of a deliberate and managed strategy. Therefore it is crucial to know whether microfinance is actually helping customers to better manage their finances and to escape the poverty traps that the poor too often find themselves in according to (World Bank & DFID 2010) report.

1.1.2 An overview of microfinance sector in Kenya

Innovative forms of microfinance and very progressive Kenyan government policies have helped to make country’s microfinance sector one of the most developed in Sub-Saharan Africa (MIX Market report 2010). Leading contributors to this dynamic in the country are M-Peso’s success in mobile banking industry, the passing of the Finance Act of 2010 allowing for agent banking, and the development of effective credit bureaus for the banking industry. According to the Microfinance Act (2006), MFIs in Kenya are classified and registered into three different tiers: deposit-taking institutions such as banks (Tier 1), credit only non-deposit taking institutions (Tier 2), and informal organizations supervised by an external agency other than the government (Tier 3). The last category involves Rotating Savings Societies (ROSCAS), club pools and financial services associations (FSAs). These distinct classifications have led to some

of the MFIs specializing in certain niche markets, which have contributed to their growth and sustainability.

Despite the enactment of the Microfinance Act (2006) and the rapid growth of Microfinance, of about 40 commercial banks and hundreds of SACCOs, 35.2 % of Kenyans are in need of financial services (unable to access the formal financial services), and another 30.2 % are entirely excluded from accessing any financial services. It is estimated that there are 3.8 million Kenyans depending entirely on NGOs, cooperatives, and the Kenya Post Office Savings Bank for financial service services, while another estimated 1.1 million depend on informal associations and groups for similar financial services offered countrywide.

According to Microfinance sector report (2012), the Kenyan microfinance sector reaches out to nearly 1.5 million borrowers with the value of the outstanding loan book standing at KES 138.4bn as of Dec 2011 which shows positive growth trends. However, growth rates in terms of borrowers are lower if compared to assets and portfolio growth, with an average of a mere 2.8% over the period under consideration. The average disbursed loan size over GDP per capita for the whole sector registers at 193% while it drops to 54% when excluding commercial banks. The Kenyan MFIs sector's network has been expanding during the period under analysis and registers a record high of 382 branches as of Dec 2011, up from 319 in Dec 2009

Nevertheless, recent favorable trends have been observed in the microfinance market. First, commercial banks are downscaling and some are reopening branches in the rural areas that they had closed down in the 90s and again opened rural branches in early 2008. Also according to the Central Bank of Kenya, a number of Tier 2 and Tier 3 Microfinance Institutions and SACCOS are in the process of transforming to deposit taking institutions (Mwaniki2006).

Profits are essential if the microfinance institution wants to carry out its mission of poverty alleviation, hence MFIs have to charge interest to cover all expenses and also to be sustainable in the long term. The industry is focusing heavily on finding ways to measure social impact, and setting industry standards by which microfinance institutions can self-regulate. Organizations are also pushing product diversification: After years of extending credit, many microfinance institutions argue that other types of financial services could have an even greater impact than loans. Savings accounts, for example, would give poor households a safe place to store emergency funds. Insurance products would help them manage risk (Credit Kenya report 2011)

1.2 Statement of the Problem

The potential growth of the microfinance industry is determined by the numbers and needs of those without access to financial services – and these are likely to grow in the long and medium term. Despite strong evidence of progress in the fight against financial exclusion, about one-third (33%) of Kenya's population is still unable to access finance in its various forms (FSD Kenya 2009). However, the greater positive impacts of MFIs on the welfare of the poor can only be sustained if the microfinance institutions can achieve a good financial performance (Biwotti & Muturi, 2014). Ndulu (2010) noted a worrying trend on the future of microfinance. The high levels of uncertainty on profitability, addressing challenges of providing financial services to the poor and unlikely substantial increase in deposits are areas of concern.

Several studies have also been done to determine specific factors affecting the financial performance of microfinance institutions using well developed MFIs in selected countries, Mulunga (2010) noted that lack of capital, high operational costs and poor regulatory framework were the main factors hampering financial performance of MFIs in Namibia. Legadima (2012)

on the other hand, concluded that high operational costs, fraud, competition from commercial banks and poor regulatory framework were the main constraints hindering financial performance of MFIs in South Africa. The level of significant of these factors in affecting the financial performance of MFIs, however, varies with studies. Some of the factors are found to be significant to a set of MFIs while some are not significant. Studies done in Kenya have not exhaustively focused on all the factors influencing financial performance of MFIs; Causes of MFIs client drop-out Njuguna (1998), high cost of credit/ capital among MFIs Mwaniki (2006), risk management challenges among MFIs Chege (2010) and challenges faced by MFIs on use of information technology Wanjiru (2011).

Hence there is need to identify which other specific constraints not covered under previous studies hinder financial performance of microfinance industry in Nairobi County Kenya. The purpose of this study therefore is to fill this gap by addressing some of these specific constraints that microfinance institutions (MFIs) face in Kenya in their attempt to increase their capacity to reach more poor people to minimize financial exclusion in Kenya.

1.3. Main Objective of the Study

To identify the main determinants to financial performance of Microfinance Institutions in Nairobi County, Kenya

Specific objectives

1. To determine the effects of Operating costs to MFIs' financial performance in Nairobi County, Kenya
2. To determine the effects of clients loan default to MFIs' financial performance in Nairobi County, Kenya

3. To determine the effects of clients drop-outs to MFIs' financial performance in Nairobi County, Kenya
4. To determine the effects of fraud cases to MFIs' financial performance in Nairobi County, Kenya

1.4 Research Questions

1. What are the effects of Operating costs to MFIs' financial performance in Nairobi County, Kenya?
2. What are the effects of clients loan default to MFIs' financial performance in Nairobi County, Kenya?
3. What are the effects of clients' drop-outs to MFIs' financial performance in Nairobi County, Kenya?
4. What are the effects of fraud cases to MFIs' financial performance in Nairobi County, Kenya?

1.5 Significance of the Study

The findings of this research will be beneficial to the following parties.

1.5.1 The government (Central Bank)

It will provide an insight on the specific constraints affecting MFIs financial performance for the government to come up with ways to eliminate some of the growth barriers.

1.5.2 Microfinance institutions

The research findings will help the MFIs management on the best ways to overcome growth barriers to increase their customer outreach and sustainability of their services for long term impact.

1.6 Scope and Limitation of Research

The study involved filling out of questionnaires by senior managers/executives of MFIs that are members of Association of Microfinance Institutions in Kenya (AMFI). The study was limited in scope to cover only institutions that are registered with AMFI and excluded the informal ones. These informal MFIs who are not members of AMFI have been excluded because it is hard to determine their existence hence difficult to obtain information from them

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter is intended to provide a summary of background information on Kenyan MFIs experiences with specific constraints undermining their financial performance. The literature review also maps out related research and studies as well as emerging trends that are relevant to this topic. This chapter is divided into five sections that provide summarized conclusions and findings from previous studies. The sections include; theoretical background, conceptual framework, empirical literature, MFIs legal framework and MFIs performance indicators.

2.2 Theoretical Background

This research follows two theories advanced by researchers in trying to explain financial growth of the firms. The two theories include Theory of firm selection and growth and integrative theory of firm growth.

2.2.1 A unified theory of firm selection and growth

Costa (2011) developed a simple unified framework to analyze firm selection and growth. The framework was based on the modeling of marketing choice - and thus demand -at the firm-level. The success of his framework suggests that carefully modeling marketing costs could be a promising avenue for a deeper understanding of firm dynamics. A key modeling simplification used in his paper is that firms incur the marketing cost to reach consumers in each period, without being able to build continuing customer relationships. This simplification made the analysis highly tractable by keeping firm efficiency as the only current decision state of the firm. Starting from the simpler case of the model with firms with very negative productivity growth select out of the market, the more so the lower their initial size. Whereas this selection

mechanism implies that the expected growth rates is inversely related to size (expression in the absence of the marketing margin it implies that the variance of the distribution of firm growth rates increases with firm size. Introducing the marketing choice of firms implies that the distribution of growth rates is fundamentally different when featuring firms with phenomenally high growth rates. Despite the fact that negative productivity growth implies that firms are more likely to exit, the more so the smaller they are, the marketing choice may still lead firms to reach very small fraction of consumers (so that their growth ratio could be arbitrarily low). In turn, this large volatility of the marketing margin implies that the variance of such firms declines with size.

2.2.2 An integrative theory of firm growth

It is Penrose (1958) and Schumpeter (1934) who gave Ghoshal (1997) the foundation for an integrative theory of firm growth. While Penrose's theory, on the one hand, offered an explanation of why and how successful firms are able to grow, it did not offer any systematic explanation of why and how the growth of successful firms can stall. Schumpeter (1934), on the other hand, explained - at least in his earlier work explained why innovative new growth opportunities are likely to be exploited by new firms leading, ultimately to a migration of resources away from existing firms. Thus, while his theory provides a powerful explanation for the decline of large established firms, it does not adequately explain why and how some of the largest firms in the world can continue to grow, often by continuing to affect innovative new products.

Expanding productive possibilities that inherently accompany resource accumulation generally lead to an expanded productive opportunity for the growing firm. But for growth to be sustainable, the firm's productive opportunity must be kept in balance by periodic administrative reorganization to motivate and accommodate the entrepreneurial judgments required to exploit

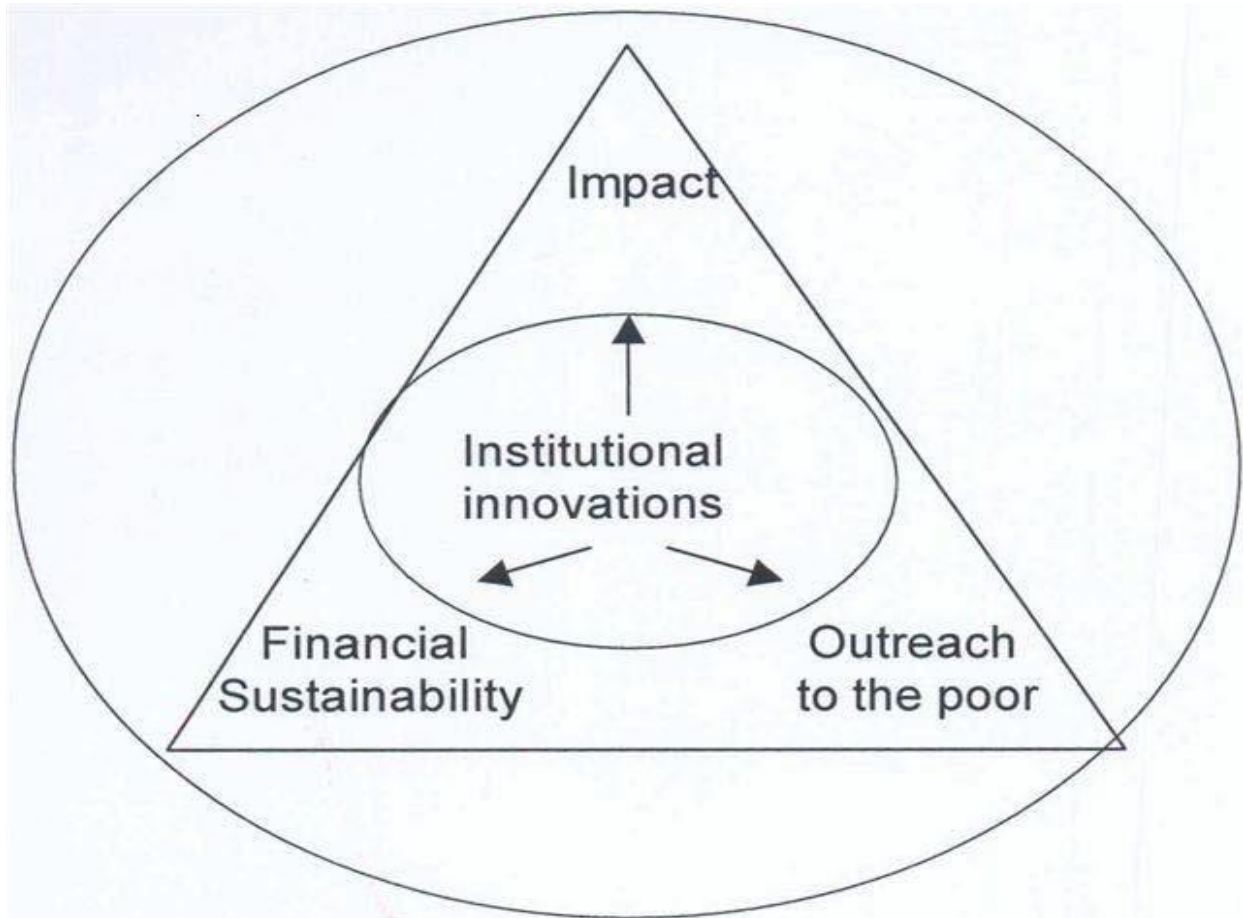
this expanding set of possibilities. Without such administrative reorganization to maintain coherency among a sufficient proportion of productive possibilities, the proportion of possibilities that remain dormant and unexploited by the firm will grow. In any vibrant economy, such a growing imbalance of unexploited possibilities will lead ultimately to a migration of those resources and their deployment to those existing and potential alternatives outside of the firm. Ghoshal (1997) noted that companies that are relatively large and complex, is of a continuous battle between the organizational capability of the firm and the discipline of the firm's external markets. The more developed and sophisticated the markets, the greater the pressure on the firm and the greater the likelihood of a migration of resources and opportunities away from it. The more a firm is able to enhance its organizational capability (through a coherent administrative framework) to develop and accommodate a diversity of entrepreneurial judgments from its members, the more easily the firm will be able to continue to grow, both horizontally and vertically in defiance of the market's discipline.

2.3 Microfinance Performance Indicators

The microfinance concept is based on the unique fundamental principles. These principles which form the basis for microfinance performance evaluation are financial sustainability, outreach and impact. (Mulunga2010) noted that microfinance performance assessment is multidimensional because these three principles cannot be assessed in isolation as they all symbolize successful microfinance programmes. Each principle therefore should have performance criteria which would then form a basis for evaluation of micro-finance effectiveness as shown in the figure below.

FIGURE 1

The Critical Microfinance Triangle



Source: Kereta (2007)

2.3.1 MFIs financial sustainability

K'Aol and Ochanda (2012) defined Sustainability as the measure of the MFI program efficiency, i.e. it is the ratio between inputs and outputs. The greater the level of outputs for a given level of inputs, the greater should be the level of efficiency. Apart from delivering loans and credits, an efficient program should translate its operations into the most cost effective way of delivering small loans to the very poor. It is therefore important to provide infrastructure needed for delivering financial services efficiently. They noted that sustainability in many MFIs schemes

was making a significant dent in poverty to achieve massive scale in order to be profitable. Programs therefore have to reach more clients, introduce more creative products, and expand their portfolios. Costs on the other hand have to be kept low to the lowest minimum per borrower and cheaper loan follow up mechanisms have to be created.

Wambugu and Ngugi (2012) noted that Microfinance institutions indeed need to be self-sustaining if they are to achieve their outreach potential providing rapid growth in access to financial services to poor people. MFIs sustainability is desirable as it allows them to access the formal sector as a source of capital, rather than relying on subsidies from government and donors to bring about growth

Microfinance sustainability is greatly influenced by: MFIs branch network, staff training levels, MFIs service quality and finally capital adequacy according to (Wambugu et.al 2012). They also noted quality service attracts new customers and also retain old ones through word of mouth or advertising which enhances MFIs sustainability because of improved financial performance. MFIs capital adequacy means more cash available to advance loans to customers and also cover default on loan portfolio. The large branch network means more outreach to customers as services are brought near these MFIs clients which translate in to more customers being served hence greater outreach and impact of the microfinance services to these poor people. Finally staff training improves their competences and boost morale hence greater output that enhances MFIs sustainability.

Macharia (2011) concluded that MFIs should adopt formalization and transparency in financial reporting product-delivery innovations, operational efficiency, sound financial management, financial market reforms, good governance and creation of value of network to achieve sustainability in the market. Product-delivery innovations and creation of Value

Networks were the most effective critical success factors for MFIs that influence sustainability of the institutions enabling the MFIs to achieve better financial performance, improve financial deriver, and improve shareholders value and firm profitability. Product-delivery innovations and creation of Value Networks with greatly influence success and sustainability of the MFIs.

Kioko (2012) found out that MFIs sustainability have been influenced by differentiated services, slacken the requisite for collaterals and beef up of the legal procedures and use of financial indicators/ratios like leverage ratios, analysis of arrears rate, analyzing the delinquency of borrowers to mention just a few, to assess, monitor and evaluate market share, credit defaults, non-performing loans and customer loyalty. He however recommended that MFIs should solicit for more funds from donors, increase the range of services they provide and beef-up their governance structure.

2.3.2 MFIs Outreach as performance indicator

Outreach refers to the number of clients served (Mulunga 2010) quoting Kereta, 2007:9). Outreach is an important aspect of microfinance in view of the fact that the fundamental aim of microfinance is to reach the largest number of poor people who do not have access to financial services. Limited outreach can impact on the sustainability in terms of benefits linked to economies of scale.

Wambugu and Ngugi (2012) their study concluded that branches diversification influenced the sustainability of KWFT MFI to a very great extent , the increase in number of branches assisted in increasing of the outreach as well as services that the MFI offered and also setting up branches closer to the people led to increase in number of customers.

Based on his study findings, (Ngomo2012) noted that MFIs keen on enhancing their financial performance should focus on increasing the number of active borrowers. Number of

active borrowers is the breadth of outreach for MFIs and therefore outreach is seen to affect financial performance of MFIs significantly. Other elements of outreach such as cost per loan, average loan size, and number of products and services offered also affect financial performance of MFIs but were not significant.

Mule, Johnson, Hickson & Mwangi (2001) advises Kenyan MFIs to look seriously at the underlying causes of their poor outreach because of both low client intake and high dropout rates. A number of African dropout studies suggest this phenomenon is resulting from client rejection of mainstream MFI credit products due to their inappropriateness to the financial needs of clients and the inconvenience associated with participation. They advised that if outreach is to be significantly improved then MFIs will have to invest much more time and resources into market research to better understand their clients' financial needs and capacities. Unfortunately the incentive to do this may not arise until donors withdraw. The MFIs may also need to look beyond their core client base and, with appropriate products, seek out additional clients who can contribute to MFI sustainability. Mule et.al (2001) also notes that if MFIs are serious about serving poor households they should be able to cater to the needs of a broader clientele without losing their ability to also effectively serve poor households Wright and Dondo (2001), advises those MFIs who are truly serious about further deepening outreach to conduct rather more careful market research to assess and understand the needs and opportunities faced by the poor. Only when this is clear then MFIs will be in a position to design products that can really address the special circumstances of the poor. Targeting poor people with wrongly designed products is likely to damage their interests as they join programmes hoping that they can manage their way around the product's terms on the basis that this is all that is being offered to them

2.3.3 MFIs Impact as performance indicator

Most MFIs seek to meet the needs of multiple stakeholders and to fulfill a number of different objectives. It is therefore apparent that the “proving” and “improving” agendas are not mutually exclusive, and most impact assessments will necessarily include a mix of approaches (Simanowtiz2001).

As the impact agenda has opened up to incorporating the needs of a greater range of stakeholders it has become clear that the impact research can be used for a wide range of purposes. The processes of understanding clients’ livelihoods and their relationship to the MFI, the needs of clients in terms of their businesses and in reducing vulnerability and poverty, and the organizational services and structures needed to deliver them, have a large number of potential benefits. (Simanowtiz2001) Impact assessment that is more focused on the needs of practitioners has moved towards looking at how impact information can feed into management and product design processes, and provide frequent and timely information. Impact assessment thus provides information that allows MFIs to improve their services, and thus improve the impact on their clients.

Copstake and Williams(2011) tentatively concluded that microcredit cannot, on its own, be relied upon to deliver sustained income growth and falling poverty rates, and that it can indeed be harmful to a significant minority of recipients. Their evidence of impact on intermediate indicators including business activity, business profitability and asset ownership was generally more positive, but this in turn did not appear to increase income or reduce poverty, not least because of the opportunity cost of time taken up with such activities. However, there was a scattering of evidence of positive impact on a range of other broader indicators of

wellbeing, including reduced vulnerability though ability to smooth consumption over time. This suggests a need to broaden the criteria on the basis of which the impact of MF is assessed.

Stewart.Van Rooyen., Dickson, Majoro. & De Wet (2010) their empirical research concluded that some MFIs clients are made poorer, and not richer, by microfinance, particularly micro-credit clients. This seems to be because: Poor people consume more instead of investing in their futures, although this may be a symptom of the credit programme – targeting the very poor, and/or lending only very small amounts may encourage consumption rather than investment. Their businesses fail to produce enough profit to pay high interest rates. Investment in other longer-term aspects of their futures not sufficient to raise their incomes high and soon enough to give a return on their investment and lastly the poor are subjected to external influences which microfinance cannot prevent, and may not alleviate.

Impact assessment is more than just the monitoring of performance outcomes. There are broader and longer term questions relating to the direct and indirect impacts of microfinance services on clients and non-clients, their communities and the local and national economies of the countries in which they live in (Simanowtiz2001) Practitioners, however, should recognize the value of increasing their understanding of their clients in terms of designing better programmes which are more effective in reaching the organizational mission, at retaining clients, and improving operational efficiency. Impact assessment studies, impact monitoring, client portfolio monitoring and market research combine to give managers useful and timely information that can be used to improve their understanding of how the MFI delivers its service and how this relates to the client needs, and to develop and improve services and products so as to become a more effective and efficient organization

2.4 Empirical Literature

In spite of the progress made so far by micro finance institutions in different parts of Kenya, both the formal and informal micro finance providers face real constraints in their attempt to extend financial services to the poor

2.4.1 Operating costs and MFIs' financial performance

Scarcity of funds for on-lending and capacity building has been cited as a constraint by several studies done in this sector as most micro finance institutions especially those that are not regulated are facing real difficulties raising funds due to scarce donor resources and lack of conventional security to borrow funds from the commercial sector .Most institutions have not yet attained financial sustainability. They lack or have inadequate capital for administrative and program support and expansion, respectively as most of them formally depended on donor funds.(Mwaniki2006) Moreover, most donors funding comes in bits, which make it difficult for MFIs to plan effectively.

Mwaniki (2006) also notes that although some MFIs put to use deposits collected from their clients, this is not a common practice. The law prohibits institutions from taking public deposits unless they are licensed under the Banking Act. Most institutions face lack or inadequate capital and funding sources as their primary challenge which is critical among the young and developing micro finance institutions. Developing new products, particularly savings products pose another challenge to MFIs, as savings products are not only important as a source of funds to MFIs but more so as a service in greater demand than credit. Hence regulatory provisions constraining MFIs from taking deposits hinder this development.

Tulchin (2004) advises that MFIs managers who wish to succeed in gaining access to new sources of capital must take concrete steps in leading their institutions, presenting MFI

performance, and communicating with investors. He discourages past behavior of MFIs that attracted donors as it is less effective in attracting investors but notes that although there are instances of MFIs raising capital from the financial markets in a variety of innovative ways but very rare. He encourages the following steps to be taken by MFIs managers planning to raise capital from the financial markets: Ensure their organizations are operating professionally, efficiently, and seeking financial self-sufficiency, alter their 'pitch' from donors to banks and investors, investigate, understand, and be comfortable with the world of bankers and investors and seek out new structures and innovations in financing

For a few of the micro finance institutions that have built some credit history with commercial banks and are therefore able to negotiate funding based on the client deposits held by these banks, their margin between the borrowing and lending rates has significantly narrowed their profit margin. These institutions are therefore not able to reduce the cost of lending to its borrowers due to the relatively high financing cost. As a result, clients will switch over to the competition to enjoy lower prices. Mwaniki (2006)

According to USAID (2004) report, financing microfinance institutions, the end results of successfully pursuing private capital will change the very nature of microfinance. The change may imply a shift in focus from foreign to local investors also adopting a private sector culture, language and governance acquisitions, and other forms of entrepreneurial dynamics, characteristic of young and growing sector. To attract a significant amount of private investment, the microfinance sector must work to explicitly break down the multiple information and regulatory barriers that separate private capital from MFIs, which will require that MFIs submit themselves to the most credible and widely accepted audits, ratings and supervision available. Despite representing only a small fraction of current supply, non-commercial capital will

continue to play a critical and catalytic role in the search for private capital. Current allocation patterns that concentrate the majority of the sector's risk capital in a small number of MFIs that are largely capable of sourcing commercial capital, however, will not encourage the growth of private capital

2.4.2 MFIs Client drop-outs and MFIs' financial performance

Client dropout is really a serious problem facing MFIs since it affects not only their profitability and sustainability but also their objectives of reducing poverty in our society. Dropout is a cost to MFIs both in human and business terms; and it is unwarranted for the institution. No MFI enrolls any member, just to say goodbye. It invests time, energy and money in selecting and training them so that it can have a well-motivated clientele with hopes and determination of overcoming poverty. When someone drops out, it is a loss for the program as it not only decreases the total number of members and borrowers, but also causes a decrease in the amount of loans outstanding and operating income for the MFI. Dropouts create incomplete groups and, in turn incomplete centers, leading to breakdown of credit discipline and contributing to low productivity of the staff. It sends a wrong signal to other members and a wrong message to the community. It damages its image and it delays sustainability. Dropouts also contribute to the overall lowering of morale within the program. Not only does the operation of the MFI suffer from the dropouts, but also its progress is hindered and its long term plans disrupted" (Latifee, 2005: 1).

Njuguna (1998) using Faulu Kenya as a case study found out that the major cause of client drop out among microfinance institutions in Kenya was poverty that made many entrepreneurs and their households extremely vulnerable to income shocks. Other factors that

also contributed to drop out were seasonal variation of the business activities they engaged in, lack of managerial skills, inaccessibility, and prospects of tapping the deposits.

Clients drop out is costly to an organization in many ways – in terms of investments in training, opportunity costs of losing the older, more experienced members most likely to take larger loans. The surprisingly high dropout rates experienced by Kenyan MFIs may be indicative of a mismatch between client attributes and conditions (overall market attributes) and product design and delivery. (Mwaniki2006) noted that this may be due to many reasons, inter alia, the inflexible financial services MFIs provide to their clients, dissatisfaction with the quality of financial services being offered by the organization or better services being offered by another MFIs. Whenever clients leave a program it will take time to bring in other new ones. At the same time, the new entrants are more risky than those who would otherwise have developed and build loyalty to the institutions. The affected MFIs usually lose on two levels: they have to repeatedly offer smaller size and riskier loans, which provide much lower returns. Consequently, they are unable expand their programs to reach more clientele, make more profits and therefore the cycle continues.

Stark and Nyirumuringa (2002), also argued that dropout can affect MFIs in different ways: The resources invested in a new member are lost, the income that would have come from the increasing loans are also lost because the larger the loan the member would have taken, the greater is the loss to the organization. Dropouts reduce morale in the MFIs from where they dropout, and this may make other members to drop out more and above all it may also make it difficult for staff to recruit new members. Damage to staff morale as high number of dropouts make staff feel that they are failing or not achieving what they hope for and so, low staff morale reduces productivity and leads to poor growth and more dropouts

2.4.3 MFIs clients loan default and MFIs' financial performance

According to Credit Kenya 2011 report titled dealing with debt, the problem of over-indebtedness has been attributed to a lack of information: Without a system of credit bureaus or official identification cards for the poor, lenders could not determine a borrower's credit history or the presence of existing loans from other lenders. MFIs that have a good information exchange about clients will be able to see that a client has multiple debts with other organizations hence correctly evaluate the client's loan application.

Bichange and Aseyo (2013) noted loan repayment default is largely a result of non-supervision of borrowers by the MFIs, as well as inadequate training of borrowers on utilization of loan funds before they received loans. They also discovered that most borrowers do not commit to spending the loan amount on intended and agreed projects. In order to minimize default, they recommend that MFIs should: educate borrowers on the need to spend less on household consumption, ensure that borrowers meet a minimum threshold in asset value before accessing loans and regularly monitor the borrowers' progress through regular account statements and physical visitations.

Mwangi (2013) concluded that there is an inverse relationship between multiple loan-taking and loan performance of the microfinance institutions. Also, there is a positive relationship between selection standards, customer relationship, cost efficiency and loan performance of the microfinance institutions. Multiple borrowing is perceived to be one of the main causes for over-indebtedness - borrowers can take on too much debt from different lenders that they eventually may not be able to repay.

Moti, Masinde, Mugenda & Sindani. (2012) their study empirical evidence showed that Credit terms formulated by the microfinance institutions, involvement of credit officers and

customers do affect loan performance. Interest rates charged had a negative effect on the performance of the loans, the higher the interest rates the lower the loan performance. Credit risk controls adopted by microfinance institutions have an effect on loan performance, credit insurance, signing of covenants with customers, diversification of loans, credit rating of customers, reports on financial conditions, refrain from further borrowing had an effect on loan performance. Collection policies adopted by microfinance institution had an effect on loan performance, stringent policy had a great impact on loan performance, and the lenient policy had an effect but was not as great as that of stringent policy

Munene & Guyo (2013) noted that there are various factors influencing non-repayment of loans which could arise from businesses characteristics. These factors included type of business, age of the business, number of employees and business profit. He recommended that the stakeholders in the microfinance finance sector ensure that the borrowers have access to adequate relevant training in the microfinance businesses. Technical training on microfinance investments and exposure to wider range of entrepreneurial environments can cushion the MFIs clients against the start-up challenges and also guide the microfinance entrepreneurs on appropriate choice of types of businesses and suitable levels of man power required by the entrepreneur

2.4.4 MFIs fraud cases and MFIs' financial performance

From the findings of his study Chege (2010) concluded that credit risk management practices enhance profitability of the MFI, improve profitability, that diversification across MFIs lead to improving shareholders values and improved savings, loan policy procedure adopted by MFIs improve investment and that human-based expert systems payment capacity help in reduction of defaults improving the performance on MFIs. The study further concluded that there was a

positive relationship between credit risk management practices and the financial performance of MFIs.

Weaknesses in proper assessment and management of business risk a challenge to micro finance service delivery e.g. staffs are not well trained or they lack the relevant skills to enable them make good loan decisions. Mwaniki (2006) the situation is further complicated by lack of business records, entrepreneurial and management capacities by the target clientele. This shortage of skilled and experienced micro-finance specialists and the high cost of hiring them is a major problem affecting MFIs. Many of the institutions analyzed lack adequate funding to build their staff capacities through training and handholding. On the other hand, some programs may not attach much value to staff training and therefore even when available, very little if any funding is directed towards the building of staff capacity.

MFIs have limited controls to protect against over frauds because lack of discussion on frauds in MFIs , MFIs have therefore downplayed the importance of fraud and this has kept them from developing effective internal control systems to mitigate against fraud risk. (Campoin2000). To be effective MFIs must institutionalize the concept of risk management into their organizational culture and environment. The MFIs internal audit department should report directly to the board and not upper management.

High transaction costs are one of the major factors limiting the expansion of micro finance, especially rural financial services. Mwaniki (2006) observed that many micro finance institutions operate manual and semi- manual management information systems which leads to high cost in processing of a large number of generally small transactions and maintaining a quality loan portfolio sometimes spread over a broad geographical area. Lack of appropriate technology-based solutions and the high cost of processing dissuade the affected programs to increase their

outreach within their operational areas, whether urban and rural. Small transactions in general require nearly as much oversight as larger ones, while providing a much smaller return.

Wanjiru (2011) found out that all the MFIs in Nyeri district were using technology. However, most of the MFIs' technology was not up to date. The challenges related to ICT included resistance to change among the employees, lack of funds to finance latest technology, and lack of technical skills to handle new technology hence MFIs were not fully benefiting from latest technology.

The proper use of MIS in microfinance relies on a very substantial investment of human and capital resources, putting them beyond the reach of some MFIs. (ACCA 2011) conference on future of microfinance advises that the MFIs industry has a responsibility to drive what solutions it can itself. The conference noted, for instance, that proponents of innovations such as cloud computing argue that they can help bring the unit costs per transaction down to the point where even small and fairly informal intermediaries should be able to afford high-quality MIS. It also noted that a range of skills are complementary to MIS and believes that intermediaries investing in information must not overlook these. Management quality is a persistent problem as professionalism and technical expertise are in short supply, while appropriate leadership is scarce and expensive. The investment in skills required to deal with the systems and structures of modern banking is substantial and MFIs are rarely able to 'buy in' expertise from banks or other major financial services providers

2.4.5 MFIs Legal framework

While regulation is important for ensuring that players maintain acceptable standards, the existing legal and regulatory framework inhibits SMEs from accessing financial services. The present framework in Kenya is basically designed to cater for the formal financial sector. It

therefore does not recognize the peculiar circumstances and methodologies required to deliver microcredit and finance to SMEs.

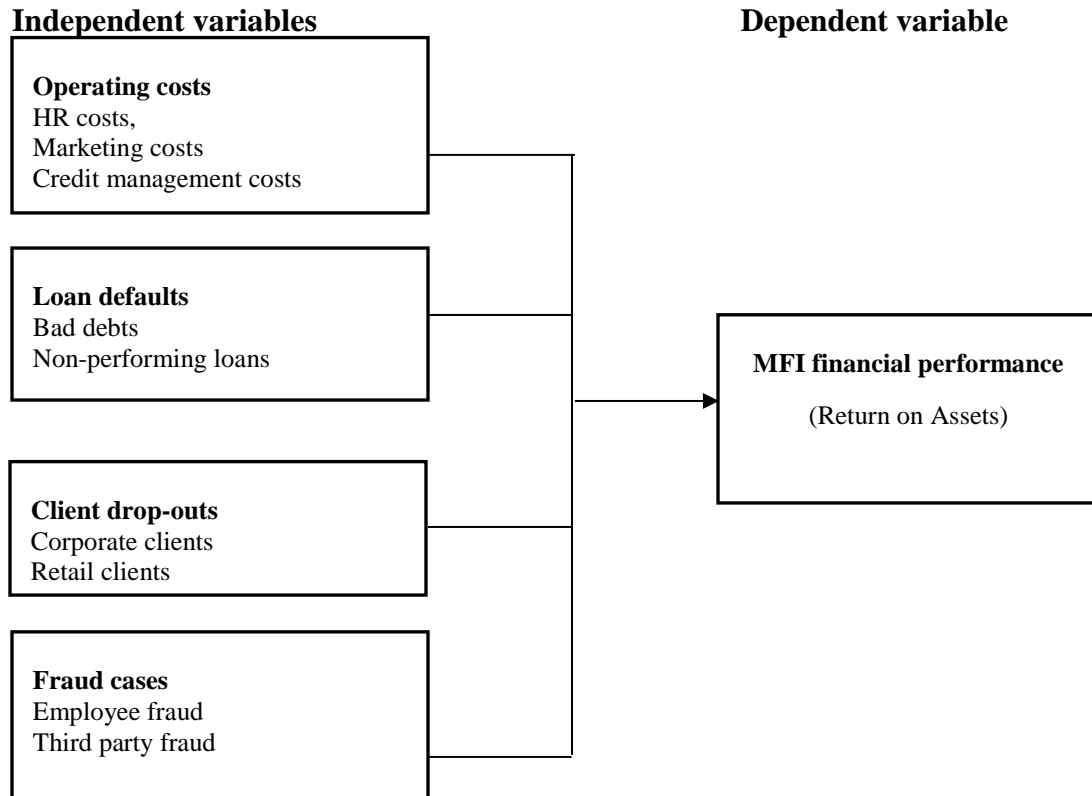
The documentation requirements are designed to focus on risks associated with traditional banking practices, assessing the value and reliability of collateral, determining financial stability of the borrower and avoiding the risk of making insider lending, as well as single large loans. A noteworthy weakness in the regulatory framework is the limitation it imposes on micro finance institutions with respect to mobilization of savings. Under the current regulatory framework, most micro finance institutions are unable to reach a large number of MSEs unless they are licensed by Central Bank of Kenya as Deposit Taking Micro finance Institution (Mwaniki2006).

2.5 Conceptual Framework

The dependent variable is MFIs financial performance measured in terms of ROA-Return on Assets achieved by MFIs over a period of five years. The independent variables include: Operating costs classified into marketing costs, human resource costs and credit management costs and measured whether they are above or below budget. The second independent variable is client drop outs classified into corporate or retail clients measured as a percentage of total clients. The third independent variable is loan default classified into bad debts or Non-performing loans as a percentage of total loans. The fourth independent variable is fraud classified into employee fraud or third party fraud as a percentage of total income

FIGURE 2

Conceptual Framework



2.6 Summary of Literature Review

From literature reviewed the information available indicates that the number of micro finance institutions in Kenya is gradually increasing and dominant market players are growing, most microfinance institutions however register slow growth and further the reasons for this with respect to Kenyan microfinance sector are not conclusive.

Despite their success so far microfinance institutions only reach a fraction of the estimated 40 million Kenyan populations. This means that there is still a big demand for microfinance services across the country. Although MFIs are meant to serve those who have been excluded from the formal banking system, there is a growing concern that many Kenyans

still lack access to financial facilities. Even with the ever growing number of microfinance institutions in Kenya, their outreach, impact and sustainability is constrained by several factors. The aim of this study therefore is to establish the factors affecting their growth and how to overcome them in future

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter covers the methods used to capture the data for the research. It details research design, research population, sample and sampling techniques, data collection instruments, data collection procedures and data processing and analysis

3.2 Research Design

The descriptive survey design would be applied in this research by administering a survey questionnaire across all of the 59 MFIs registered with Association of Microfinance Institutions of Kenya drawn from within Nairobi region. Some of the main reasons of choosing descriptive survey designs for this research to collect primary raw data from respondents (MFIs) are; ability to accommodate large sample sizes' generalizability of results, ability to distinguish small differences between diverse samples groups, ease of administering and recording questions and answers, increased capabilities of using advanced statistical analysis; and abilities of tapping into latent factors and relationships.

3.3 Target Population

Mugenda and Mugenda (2003) describe population as all the elements that meet the criteria for inclusion in a study. Population is therefore the entire group of individuals, events or objects having a common observable characteristic. The target populations in this study are MFIs registered with Association of microfinance instructions within Nairobi County listed on the AMFI website. The units of analysis are the 59 senior managers/ Chief Executives/ Finance executives of the microfinance institutions registered with AMFI in Kenya.

3.4 Sample Size and Sampling Technique

Census of all the 59 MFIs registered with Association of Microfinance Institutions of Kenya found on AMFI website was carried out. In this study one chief executive officer or senior manager of selected MFIs formed the sampling units because it is the senior management who has the overall knowledge and information on the determinants of their MFIs financial performance.

3.5 Sources of Data

Data came from MFIs financial records and filled questionnaires conducted with micro finance institutions senior managers.

3.6 Methods of Data collection

The tool used in data collection from respondents is a questionnaire. This research was based on a survey that was designed in the form of a questionnaire that was completed by members of senior management or staff at the surveyed MFIs. The survey questionnaire is best suited for this exercise, because it allows the collection of information in the form of primary data from the microfinance senior staff or management in the county. The quantitative data was in a form of numerical ratings assigned to each problem or issue. The questionnaire was preferred because it is easier to administer and the level of biasness will be low because all the questions were standardized.

3.7 Data Collection Procedures

The questionnaires were issued to the respondents through informal self-introduction and through email. The questionnaires were sent to the respondents under a questionnaire forwarding letter. Follow ups were made and the fully completed questionnaires were picked from the respondents after one week by use of a research assistant or through email.

3.7.1 Reliability and validity

Data reliability and validity was tested through a pilot test. Validity was improved by involving the supervisor and industry professionals on whether the questionnaire was gauging constraints that affect MFIs financial performance results correctly.

3.8 Data Analysis and Model Specification

The collected data will be analyzed through descriptive and inferential statistics. Descriptive statistical tools that will be used will include frequencies and percentages while inferential statistical tools will include multiple regression analysis. Zikmund (2003) defines descriptive analysis as the transformation of raw data into a form that will make it easy to understand, interpret and draw conclusions out of it. Pearson's Simple Correlation (r) analysis will be used to confirm the nature and strength of the relationship between some variables.

Multiple Regression analysis will be used to establish causal relationships between variables and the degree of causal effect of the independent variables on the dependent variable. There are four independent variables and a moderating variable that will affect the dependent variable MFIs financial performance. These relationships will be determined using multiple regression models

The model below will be used for every objective.

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon \dots \dots \dots (i)$$

Where:

Y= MFI Financial Growth

α is the constant term

β is the beta coefficient

X₁= Operating Costs

X_2 = Client Drop Out

X_3 = Client Loan Default

X_4 = Fraud cases

e is the error term

3.9 Operationalization of Variables

The Operationalization framework serves a significant purpose since it tries to explain how each of the variables mentioned in the study will be measured. This study has one dependent variable which is MFIs' financial performance-ROA (Return on Assets). The study conceives that MFI financial performance is affected by clients' dropouts (classified into retail and corporate clients), loan defaults-(bad debts or non -performing loans), operating costs-(marketing costs, credit management costs and human resource costs) and fraud cases (staff frauds' or third party frauds). These factors are the independent variables of the study and can be measured by looking at various elements that form the variables.

TABLE 1**Operationalization of Variables**

Variable	Prox	Measure	Method of analysis
Dependent variable Financial growth	Y	Profitability-ROA (Return on Assets)	Quantitative
Independent variables			
Operational costs	X1	Marketing costs	Above or below budget
		HR costs	Above or below budget
		Credit management costs	Above or below budget
Client drop-out	X2	Corporate clients	% of total corporate clients
		Retail clients	% of total retail clients
Client loan default	X3	Nonperforming loans	% of total loans
		Bad debts	% of total loans
Fraud	X4	Employee fraud	% of total income
		Third party fraud	% of total income

CHAPTER FOUR

RESEARCH FINDINGS AND DISCUSSION

4.1 Introduction

This chapter comprises of data analysis, findings and interpretation. Results are presented in tables and diagrams. The analyzed data was arranged under themes that reflect the research objectives

4.2 Response Rate

Semi-structured questionnaires were distributed to the 59 MFIs in Nairobi. 54 of the questionnaires were returned making a response rate of 91.5%. This fell within Mugenda and Mugenda's (2003) prescribed significant response rate for statistical analysis, established at a minimal value of 50%. Fincham (2008) stated that low response rate can give rise to sampling bias while higher response rates assure more accurate survey results and recommended a minimal response rate of 60%.

TABLE 2

Response Rate

Questionnaires	Frequency	Percentage
Filled in Questionnaires	54	91.5%
Unfilled Questionnaires	5	8.5%
Total	59	100

4.3 Demographics of the Respondents

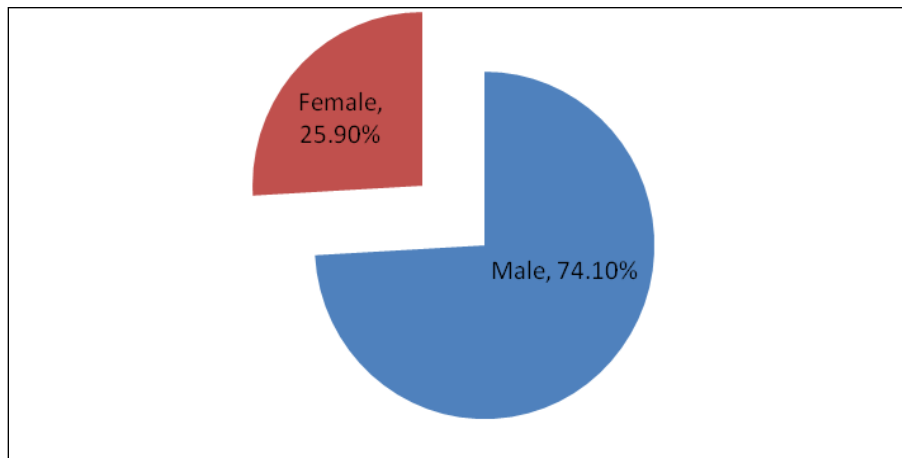
This section consists of information that describes basic characteristics such as gender, age, position of the respondents and level of education.

4.3.1 Gender of respondents

The respondents were asked to indicate their gender. Majority of the respondents were male who represented 74.1% of the sample while 25.9% were female. This implies that the leadership of the MFIs in Nairobi County is male dominated. The reason attributed to this may be due to the existing gender gap in employment in Kenya and the nature of the work in the sector which require a lot of movement and outreach activities.

FIGURE 3

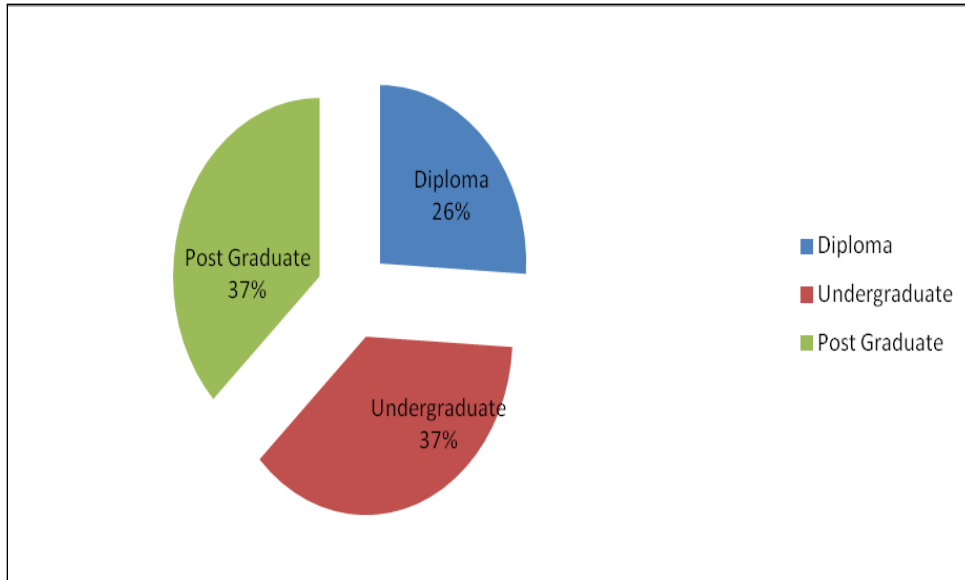
Gender of Respondents



4.3.2 Level of education

The respondents were asked to state their levels of education. Results in Figure 4.2 show that 26% of the respondents had diploma qualifications, 37% had undergraduate qualification and, 37% had a postgraduate qualification. This implies that the leadership of the MFIs had education up to the advanced level which was attributed to the increased expansion of higher education opportunities in Kenya. This also means that MFIs management in Nairobi County has the requisite management skills required of running profitable institutions.

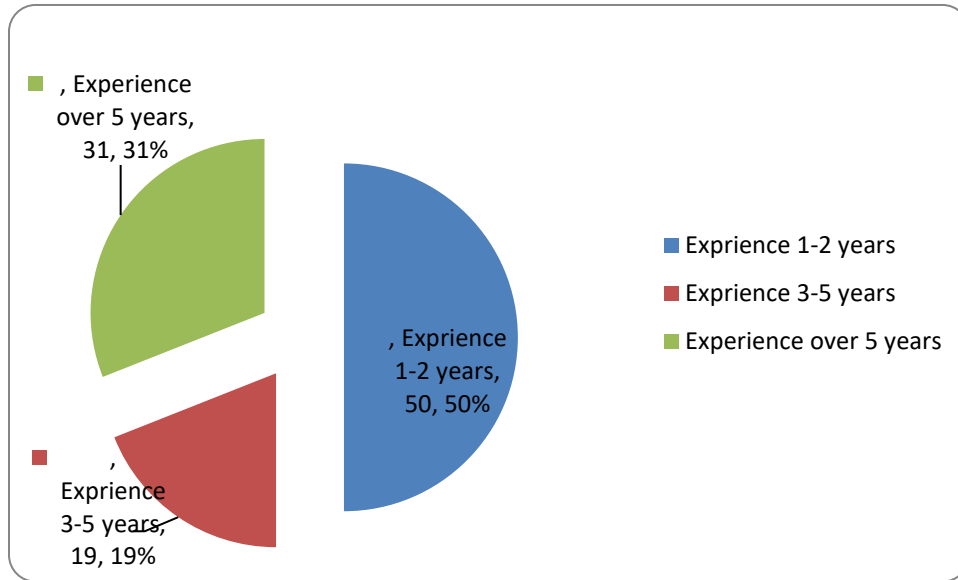
FIGURE 4
Level of Education



4.3.3 Working experience

The study further wanted to establish the working experience of the respondents. This was important since previous studies indicated strong relationship between work experience of employees and financial performance of microfinance institutions. Most of the respondents (50%) had between 1 – 2 years working experience in the institution. Cumulatively, more than 69% had less than 5 years of working experience while only 31% had more than 5 years working experience. This can be attributed to the fact that most private sector institutions have employees on short-term contracts in an attempt to minimize human resource costs, maximize productivity and to enhance employee performance which ultimately is geared towards enhanced performance of the microfinance institution.

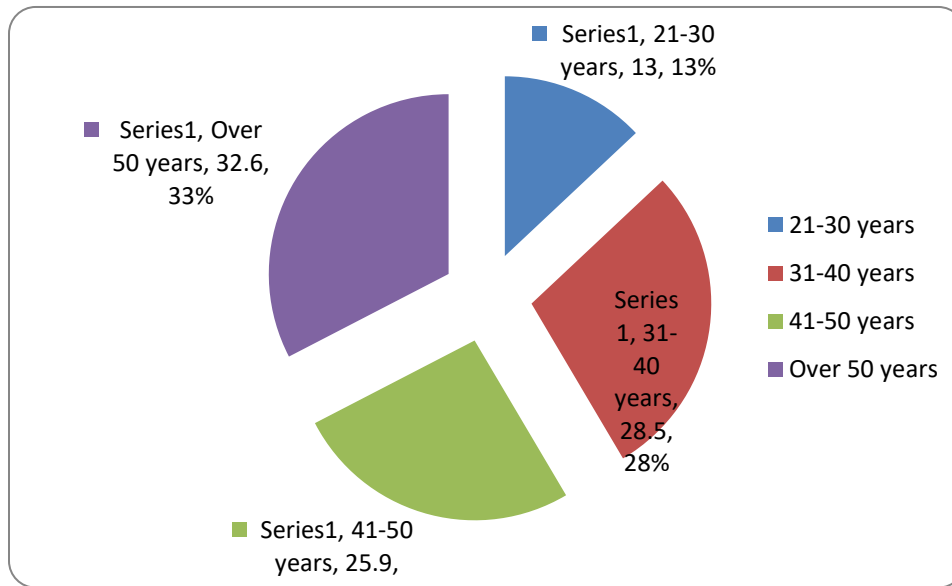
FIGURE 5
Working Experience



4.3.4 Age of the respondents

The respondents were asked to state their age. Results in Figure 4.4 show that 13% of the respondents were aged between 21-30 years, 28% aged 31-40 years, 26% aged between 41-50 years and 33% indicated they were over 51 years old. This implies that the leadership of the MFIS had respondents mature enough to understand the specific constraints affecting MFIs financial growth. This can also be attributed to the high rate of unemployment in Kenya which has made the younger generation to seek employment in other sectors of the economy.

FIGURE 6
Age of Respondents



4.4 Determinants of microfinance growth in Nairobi county Kenya

4.4.1 Effects of operating costs to MFIs financial performance

TABLE 3
Effects of Operating Costs

Question		Frequency	Percent
To what extent do operational costs affect financial performance of the MFI	low extent	1	1.9
	moderate extent	30	55.6
	high extent	23	42.6
	Total	54	100

The study sought to determine to what extent operational costs affect performance of the MFIs. 1.9% of the respondents indicated that operational costs affect performance of the MFIs to a low extent, a slight majority, 55.6% indicated performance was affected moderately while 42.6% indicated operational costs affected performance to a high extent.

TABLE 4
Effects of Human Resource, Marketing and Credit Management Costs

Question	Response	Frequency	Percent
Describe the status of Human Resource Cost as an operational cost.	Below budget	4	7.4
	Above budget by 0-10%	14	25.9
	Above budget by 11-20%	7	13
	Above budget by 21-30%	14	25.9
	Above budget by over 30%	15	27.8
	Total		54
Describe the status of marketing Cost as an operational cost.	Below budget	5	9.3
	Above budget by 0-10%	10	18.5
	Above budget by 11-20%	17	31.5
	Above budget by 21-30%	10	18.5
	Above budget by over 30%	12	22.2
	Total		54
Describe the status of credit management Cost as an operational cost.	Below budget	7	13
	Above budget by 0-10%	8	14.8
	Above budget by 11-20%	9	16.7
	Above budget by 21-30%	15	27.8
	Above budget by over 30%	15	27.8
	Total		54

The respondents were further asked to indicate the proportion of the total budget that Human Resource, marketing and credit management costs take up. The aggregated of frequencies for Below budget, Above budget by 0-10%, Above budget by 11-20%, Above budget by 21-30% and Above budget by over 30% responses were used to guide the interpretation of the results. Majority of the respondents 92.6% indicated that the Human Resources cost are above budget, 90.6% indicated that marketing costs were above allocated budget and 87% indicated that credit management costs were above its budgetary allocation. These results indicate that MFIs are facing high operational costs. These findings are consistent with that of Brown, Lafourcade, Isam and Mwangi (2013) that indicated that African MFIs face many challenges. Operating and financial expenses are high, and on average, revenues remain

lower than in other global regions. Efficiency in terms of cost per borrower is lowest for African MFIs.

4.4.2 Effects of client drop out to MFIs performance

TABLE 5
Effects of Client Drop

Question	Response	Frequency	Percent
Do what extent do corporate clients dropout affect MFIs financial performance	low extent	9	16.7
	moderate extent	21	38.9
	high extent	24	44.4
	Total	54	100
Do what extent do retail clients dropout affect MFIs financial performance	low extent	9	16.7
	moderate extent	19	35.2
	high extent	26	48.1
	Total	54	100

The study sought to determine to what extent client drop out affect performance of the MFIs. 38.9% of the respondents indicated that corporate client drop out affect performance of the MFIs to moderate extent while 44.4% indicated corporate client drop out affected performance to a high extent. On the question of retail client dropout rate, 35.2% indicated this affected performance to a moderate extent while a large majority 48.1% indicated performance was affected to a high extent. This confirms the findings by Meyer, Graham and Pagura (2011) who examined the determinants of borrower dropouts. Findings revealed that retaining clients is very important for MFIs because it reduces MFI's administrative costs, lowers default risks and increases the average loan balance as well as the institution's productivity.

TABLE 6
Effects of Corporate Clients and Retail Clients Dropout

Question	Response	Frequency	Percent
Corporate Clients	0-5%	9	16.7
Describe the status of corporate clients dropout as a Percentage of total corporate clients in your MFI	6-10%	20	37
	11-20%	6	11.1
	21-30%	12	22.2
	over 30%	7	13
	Total	54	100
Retail Clients			
Describe the status of retail clients dropout as a Percentage of total retail clients in your MFI	0-5%	5	9.3
	6-10%	17	31.5
	11-20%	5	9.3
	21-30%	16	29.6
	over 30%	11	20.4
Total	54	100	

The study further sought to determine the status of both corporate and retail client drop out. The aggregated of frequencies of 0-5%, 6-10%, 11-20%, 21-30% and over 30% responses were used to guide the interpretation of the results. The results are presented above. Results indicate that there are high levels of client drop outs. Mulunga (2010) indicated that dropout rates points to the recognition that dropouts affect financial sustainability in both the short and long-term. Put simply, a dropout is a potential client lost, and without clients the MFI cannot exist. A high number of dropouts without replacement will immediately affect the growth and sustainability of a MFI. In the long-run, consistently high dropout rates may worry investors, who will in turn reduce funding and hinder growth.

4.4.3 Effects of client loan default to MFIs performance

TABLE 7
Effects of Client Loan Default

Question	Response	Frequency	Percent
Do what extent do clients loan default affect MFIs financial performance	low extent	10	18.5
	moderate extent	25	46.3
	high extent	19	35.2
	Total	54	100

The study sought to determine to what extent client loan default affect performance of the MFIs. 18.5% of the respondents indicated that client loan default affect performance of the MFIs to a low extent, a slight majority, 46.3% indicated performance was affected moderately while 35.2% indicated client loan default affected performance to a high extent. These findings agree with those of Kato (2013) who investigated the effect of loan performance on profitability of financial institutions. The findings indicated that there was a negative relationship between loan default and profitability of MFIs: the level of loan default kept on increasing; that is, loan defaulters were many thus leading to high collection costs which cut down the profits of the MFIs.

TABLE 8
Effects of Non-performing Loans and Bad Debts

Question	Response	Frequency	Percentage
Describe the status of Non -Performing Loans In your institution.	0-2% of total loans	5	9.3
	3-4% of total loans	5	9.3
	5-7% of total loans	13	24
	8-10% of total loans	13	24
	Over 10% of total loans	18	33.3
	Total	54	100
Describe the status of Bad Debt in your institution	0-2% of total debt	4	7.4
	3-4% of total debt	5	9.3
	5-7% of total debt	14	25.9
	8-10% of total debt	15	27.8
	Over 10% of total debt	16	29.6
	Total	54	100

The study further sought to establish the proportion of total loans that bad debt and non - performing loans represented in the MFIs. 42.6% of the respondents indicated that NPL represented 0-7% of the total loans, 24% indicated that NPL represented 8-10% of the total loans while 33.3% indicated that NPL represented over 10% of the total loans. Results bad debts represented a proportion of the total debt. These results indicate that MFIs are faced with a problem of client loan default. Wangai, Bosire and Gathogo (2014) established that, credit risk significantly affected financial performance of MFIs. The credit risk negated the MFIs' financial performance. It was deduced that, increase in credit risk would significantly reduce the MFIs' financial performance.

4.4.4 Effects of fraud to MFIs Performance

TABLE 9
Effects of Fraud

Question	Response	Frequency	Percent
Do what extent do fraud affect MFIs financial performance	low extent	39	72.2
	moderate extent	11	20.4
	high extent	4	7.4
	Total	54	100

The study sought to determine to what extent fraud affect performance of the MFIs. 72.2% of the respondents indicated that fraud affect performance of the MFIs to a low extent, 20.4% to moderate extent while 7.4% indicated fraud affected performance to a high extent. This indicates that fraud is not a problem to MFIs surveyed or they could be hiding the true picture to save the image of their institutions.

TABLE 10
Effects of Employees and Third Party Fraud

Question	Response	Frequency	Percent
Employee Fraud			
Describe the status of Employee fraud as a Percentage of total income	0-1% of total income	27	50
	2-5% of total income	12	22.2
	6-8% of total income	9	16.7
	9-10% of total income	3	5.5
	Over 10% of total income	3	5.5
	Total		54
Third Party Fraud			
Describe the status of Third party fraud as a Percentage of total income	0-1% of total income	29	53.7
	2-5% of total income	10	18.5
	6-8% of total income	8	14.8
	9-10% of total income	4	7.4
	Over 10% of total income	3	5.6

On the question of the status of fraud in the MFI, the respondents were asked to indicate the percentage of employee fraud and third party fraud in relation to total income. Results indicated that fraud cases did not significantly MFIs financial growth.

4.5 Regression

R²=0.5371 Adjusted R²=0.5015

TABLE 11
Analysis of Variance

	Sum of Squares	df	Mean squares	F	Sig
Regression	3.2474361	4	0.811859	14.33	0.000
Residual	2.776267	49	0.056659		
Total	6.023703	53	0.113655		

F ratio=14.33 is greater than tabulated F_{0.05} (4, 49) ~2.61

P value is significant=0.000<0.05 (level of significance).

Model is useful in explaining the determinants of microfinance financial growth

TABLE 12
Regression Results

	Coefficient	SE Coefficient	P value	
Constant	3.639839	0.20196	0.000	Significant
Ave. Operational costs	-0.1056675	0.034834	0.004	Significant
Ave. Clients drop out	-0.1259933	0.059272	0.039	Significant
Ave. Client loan default	-0.1663891	0.04471	0.001	Significant
Average fraud	-0.0855852	0.056517	0.136	Not significant

$$Y=3.6398-0.10567x_1-0.122599x_2-0.16639x_3-0.08559x_4+ \epsilon \dots\dots\dots (ii)$$

The partial change in MFIs' financial performance (Y) = -0.1057 when operational costs (X1) is adjusted by one unit while holding other variables in the model constant.

The partial change in MFIs' financial performance (Y) = -0.12599 when client dropout (X2) is adjusted by one unit while holding other variables in the model constant.

The partial change in MFIs' financial performance (Y) = -0.16639 when client loan default (X3) is adjusted by one unit while holding other variables in the model constant.

The partial change in MFIs' financial performance (Y) = -0.08559 when fraud (X4) is adjusted by one unit while holding other variables in the model constant

4.5.1 Operational costs

A Multiple regression was conducted to establish the effect of operational costs as a constraint to MFIs financial growth. Table 4.42 results indicate that an increase in operational costs significantly decreases the predicted probability of financial growth by -0.10567, holding all other factors constant. The implication is that high operational costs may be associated with low rates of MFI financial growth. Hence, a decrease in the operational costs can be associated with higher MFI performance and growth. The negative and significant relationship registered between operational costs and MFIs financial growth agree with the findings of Mulunga (2010) who identified high operational costs as one of the problems that impact negatively on the financial growth of microfinance finance institutions (MFIs) in Namibia. Her research findings also revealed that, lack of capital and poor regulatory framework were the main problem areas hampering the growth of MFIs Namibia.

4.5.2 Client dropout

Table 4.4.2 revealed that an increase in client drop out significantly decreases the predicted probability of financial performance by- 0.12599, holding all other factors constant. The implication is that high client drop out may be associated with low rates of MFI financial growth. Hence, a decrease in the client dropout rate may lead to higher MFI financial growth. The negative and significant relationship witnessed between clients dropout and MFIs financial growth agree with that of Njuguna (1998) who found out that the major cause of client drop out among microfinance institutions in Kenya was poverty that made many poor people and their small businesses extremely vulnerable to income shocks, seasonal variation of the business activities they engaged in and lack of managerial skills to run their businesses.

4.5.3 Client loan defaults

From table 4.4.2, an increase in client loan default rate significantly decreases the predicted probability of MFIs financial performance by -0.166389, holding all other factors constant. The negative and significant relationship established by the regression analysis between loan default and MFIs financial growth is consistent with that of Ntamoah, Oteng, Opoku and Siaw (2014) whose main purpose was to study the impact of loan default rate on profitability. Findings revealed that that there is a strong relationship between problem of recovery and overdue of loans and deficient analysis of project viability. These relations are positive, meaning proper management of loans given to clients will results in higher profitability of firms

4.5.4 Fraud cases

Table 4.4.2 results reveals that an increase in fraud does not significantly decrease the predicted probability of MFIs financial performance holding all other factors constant. The observed negative but not significant relationship between fraud and MFIs financial growth findings are in

disagreement with those of Akwasi (2015) who examined the challenges and prospects of microfinance institutions. The study findings revealed that key constraints faced by MFIs include poor regulatory environment, corruption, frauds and forgeries and poor corporate governance.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter provides relevant discussion on the research objective from data processed in the previous chapter. This chapter presents the summary of the data findings presented in the previous chapter, conclusions and recommendations there-to. The chapter is, thus, structured into summary, conclusions, and recommendations of research findings and further research.

5.2 Summary of Findings

The study was undertaken to look into factors that constrain MFI financial growth in Nairobi County. Based on this preposition, theoretical literature was reviewed. The study examined several empirical literatures relevant to the study area. Based on theories, empirical work and literature, conceptual framework of the relationship between independent and dependent variables was drawn. Data was collected from 54 institutions through a questionnaire. The study achieved a response rate of 91% which was above the postulated 50% minimum (Mugenda and Mugenda, 2003). Descriptive analysis and multiple regression models were conducted.

5.2.1 *Operational costs*

Data analysis indicated that MFIs incurred Human resource, marketing and credit management costs above budgetary allocations and that these high operating costs impacted negatively on financial performance to a high extent. Based on the regression, Operating costs were found to have a negative (-0.1056675) and significant association (p value 0.004) with MFIs financial performance.

5.2.2 Client loan defaults

There were high loan default rates including non -performing loans and bad debts. This had a negative effect on financial performance of the MFIs. Results of the multiple regressions indicated a negative (-0.1663891) and significant association (p value 0.001) between client loan default and MFI financial performance.

5.2.3 Client dropouts

Client dropout rate, both corporate and retail was observed to be high and impacted negatively on performance to a great extent. Results of the multiple regressions indicated a negative (-0.1259933) and significant association (p value 0.039) between client drop out and MFI performance.

5.2.4 Fraud cases

Descriptive results indicated that both employee fraud and third party fraud negatively impacted on performance to a lesser extent. Results of the multiple regressions indicated a negative (-0.0855852) but not a significant association (p value 0.136) between fraud and MFI financial performance.

5.3 Conclusions

Based on both descriptive and multiple regressions results, study concluded that high human resource, marketing and credit management costs are ideal factors that affect the performance of MFIs. From the data analyzed the study therefore asserts that there is a significant negative relationship between high operation costs, and MFI growth.

Secondly, the study concluded that client loan default greatly affect performance. These were guided by both descriptive and inferential data analysis results that revealed that non - performing loans and bad debts were significant. From results of the multiple regression analysis conducted the study established that there is a significant negative relationship between client loan default and MFI growth.

The study concluded that client drop out greatly negatively and significantly affected MFIs financial performance. Both descriptive and multiple regression analysis of data collected revealed that both corporate and retail client drop outs were significant in determining MFIs financial growth, hence there is a significant negative relationship between client drop out and MFI growth.

The study concluded that fraud did not greatly affect performance. Data analysis revealed that both employee and third party fraud were not significant in determining MFIs financial growth.

5.4 Recommendations

Several policy implications emanate from the study. MFIs managers to look for other ways in gaining access to new sources of capital to reduce costs of capital (high operating costs) e.g. consider raising capital from financial markets for onward lending to their clients instead of relying on loans from commercial banks which are always expensive.

To reduce loan default MFIs should require credit officers to visit the client and the client to receive training prior to the disbursement of each loan. It is easy for MFIs to assume that a client should get larger loans after each loan cycle, assuming that clients will repay new loans on time if they have repaid past loans on time. However, it is often on the second and third loans that clients fall behind, perhaps because the loan size has grown too big or because the client has

begun to take the MFI for granted. The MFI should apply the same rigorous financial and character tests to both new and repeat loans.

MFIs should recruit skilled personnel especially credit officers and they should be regularly trained. Another strategy for reducing arrears is to loan only to micro entrepreneurs who have been in business for at least twelve months. Businesses are most likely to fail within the first year of operation so if they have existed for at least twelve months on the startup capital, the infusion of money from the MFI should be at a lower risk than if the business is a start-up. Multiple borrowing by MFIs clients is perceived to be one of the main causes for high cases of loan default among MFIs; hence they (MFIs clients) should be incorporated into credit reference bureau with commercial banks for them to have a good information exchange about clients past credit history before advancing micro loans

MFIs clients' dissatisfaction with the quality of financial services being offered could be the main reasons why clients drop-out of these programs. To effectively address this problem MFIs should take the first step of understanding their customer financial needs before coming up with products to offer them; this can be achieved through investing in market research and strong customer relationship management training for their staff. Other reasons for dissatisfaction with MFI financial products could be due to their inappropriateness to the financial needs of clients and the inconvenience associated with participation needs and capacities which can also be solved through strong market research about customer needs.

The dropout rate situation demands introduction of innovative micro credit products. These may include Business responsive products, Build client loyalty through range of service and appropriate staff incentives and training

To mitigate fraud, the study recommends Human resource policies that stress culture of excellence remuneration for hard work and fairness in the treatment of personnel and adequate internal control and segregation of duties especially in areas of cash handling, loan write offs and rescheduling. The study also recommends Credit committee effectiveness with internal and external audit function. Efficient and effective regulatory and anti- corruption institutions at the macro level and the introduction of forensic accounting and enforcement and full implementation of whistle blowing.

To develop effective internal control systems to mitigate against fraud risk MFIs must institutionalize the concept of risk management into their organizational culture e.g. adopting the latest technology (MIS) in their daily operations and have their internal audit department report directly to the MFIs board and not senior management

To effectively manage both business and financial risks, MFIs should have staff training programs where staffs are well trained with the relevant skills to enable them make good loan appraisals/decisions as this will reduce cases of client loan default. MFIs should also ensure that their clients have access to adequate relevant business training in the microfinance. The training on microfinance investments and exposure to wider range of entrepreneurial environments can cushion the MFIs clients against the start-up challenges and also guide them on appropriate choice of types of businesses and suitable levels of man power required by the entrepreneur as this will reduce cases of loan default

5.5 Suggestions for Further Research

A similar study need to be conducted comparing internal and external factors that affect MFI financial performance in the whole country as this study focused only on Nairobi County.

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APPENDIX I

Introduction Letter

Dear Sir/Madam

A survey of constraints to growth of microfinance institutions in Nairobi County.

I am currently a Masters student at KCA University School of Business and Public Management. The field of my study is Finance and Investment. You are part of a sample of providers of micro finance services and other products to lower income groups, so I kindly ask you for your co-operation.

I can assure you that:

- a) The results would be anonymous and
- b) No strategic information is required.

This is perception survey, so there are no real wrong or right answers, but I ask you to be as honest as possible in reflecting on the issues raised.

I thank you for your time.

PS: Feel free to contact me if there is any uncertainty regarding any questions or issues.

Kindly contact me on the on the details below once done;

Kind regards

Daniel Ambundo Munala

Mobile: 0723391961

020-3505176

APPENDIX II

Research Questionnaire

CONFIDENTIALITY CLAUSE:

The responses you provide will be used for academic purposes and will be strictly confidential.

SECTION A: Demographic data

1. Gender

a) Male

b) Female

2. Highest level of education

a) Diploma level

b) Undergraduate level

d) Post graduate level

3. Working experience

a) 1-2 years

b) 2-3 years

c) Over 3 years

4. Age

a) 21-30 years

b) 31-40 years

c) 41-50 years

d) 51 years & above

	Low extent	Moderate extent	High extent
To what extent do operational costs affect financial performance of the MFI?			
To what extent do corporate client drop out affect financial performance of the MFI			
To what extent do retail client drop out affect financial performance of the MFI			
To what extent do loan default by clients affect financial performance of the MFI			
To what extent do fraud affect financial performance of the MFI			

SECTION B: OPERATIONAL COSTS

2. Which of the following statements best describes the status of operational costs in your organization?

Budget	Below budget	Above budget by 0-10%	Above budget by 11-20%	Above budget by 21-30%	Above budget by over 30%
Human resource costs					
Marketing costs					
Credit management costs					

SECTION C: CLIENT DROP OUT

3. Which of the following best describes the status of client dropout rates in the MFI as a percentage of total customers?

% of total customers	0-5%	6-10%	11-20%	21-30%	Over 30%
Retail clients dropouts rates					
Corporate clients dropouts rates					

SECTION D: LOAN DEFAULT

1. Which of the following best describes the status of loans default by MFIs clients as a percentage of total loans?

% of total loans	0-2%	3-4%	5-7%	8-10%	Over 10%
Non- performing loans					
% of total debt	0-2%	3-4%	5-7%	8-10%	Over 10%
Bad debts written off					

SECTION E: FRAUD

2. Which of the following best describes the status of fraud in the MFI as a percentage of total income?

% of total income	0-1%	2-5%	6-8%	9-10%	Over 10%
Employee fraud					
Third party fraud					

SECTION F: MFI FINANCIAL PERFORMANCE

What was the ROA (Return on Assets) for the following years?

Return on Assets-ROA	0-1%	2-5%	6-8%	9-10%	Over 10%
Year 2010					
Year 2011					
Year 2012					
Year 2013					
Year 2014					

TABLE A1**Scores of Operational Costs on a Likert Scale**

HR_cost	Mrktng_cost	Credit_mngt cost	AV OPERA COSTS
1	2	1	1.33333333
4	3	3	3.33333333
4	4	5	4.33333333
2	2	1	1.66666667
1	2	1	1.33333333
2	1	2	1.66666667
4	4	4	4
5	4	5	4.66666667
1	2	1	1.33333333
1	1	1	1
4	4	5	4.33333333
2	2	1	1.66666667
5	4	5	4.66666667
2	1	2	1.66666667
2	2	1	1.66666667
2	1	2	1.66666667
5	5	5	5
5	3	3	3.66666667
2	1	2	1.66666667
2	2	2	2
3	4	3	3.33333333
5	3	5	4.33333333
5	3	5	4.33333333
5	2	2	3
5	2	3	3.33333333
5	3	3	3.66666667
3	5	3	3.66666667
5	2	3	3.33333333
4	3	2	3
2	5	2	3
3	3	3	3
3	3	3	3
5	3	3	3.66666667
2	3	1	2
2	4	3	3
3	3	2	2.66666667
3	4	2	3

3	3	3	3
3	4	1	2.66666667
2	4	4	3.33333333
2	3	4	3
2	5	4	3.66666667
2	5	5	4
2	5	4	3.66666667
2	3	5	3.33333333
1	5	3	3
1	3	4	2.66666667
1	5	4	3.33333333
3	5	3	3.66666667
4	3	3	3.33333333
2	5	4	3.66666667
5	5	4	4.66666667
2	3	4	3
5	5	3	4.33333333

TABLE B1**Scores of Clients Drop Out on a Likert Scale**

Retail drop	corp_drp1	AV DROPOUT
3	1	2
3	1	2
3	3	3
3	4	3.5
3	5	4
2	2	2
2	2	2
3	1	2
2	2	2
3	2	2.5
3	1	2
2	2	2
3	3	3
2	2	2
3	3	3
3	3	3
3	3	3
2	3	2.5
3	3	3
3	3	3
2	3	2.5
2	3	2.5
2	3	2.5
2	5	3.5
2	2	2
3	2	2.5
3	1	2
2	2	2
3	2	2.5
3	2	2.5
3	1	2
2	3	2.5
2	3	2.5
3	2	2.5
2	2	2
3	3	3
3	3	3

3	3	3
3	2	2.5
3	2	2.5
3	2	2.5
3	2	2.5
3	2	2.5
3	2	2.5
3	1	2
3	1	2
3	1	2
3	3	3
3	4	3.5
3	2	2.5
3	5	4
3	2	2.5
2	5	3.5
3	5	4

TABLE C1**Scores of Clients Loan Default on a Likert Scale**

npl	bad debts	AV DEFAULT
3	2	2.5
2	3	2.5
2	3	2.5
2	3	2.5
2	2	2
2	3	2.5
1	2	1.5
2	2	2
2	3	2.5
1	3	2
2	2	2
3	3	3
2	3	2.5
3	3	3
3	3	3
3	2	2.5
3	3	3
3	2	2.5
3	2	2.5
3	3	3
3	3	3
3	3	3
3	3	3
3	2	2.5
3	2	2.5
3	3	3
3	2	2.5
3	2	2.5
3	3	3
2	3	2.5
2	2	2
2	3	2.5
2	3	2.5
2	2	2
2	2	2
1	3	2
1	2	1.5

1	3	2
3	2	2.5
4	5	4.5
2	2	2
5	4	4.5
2	1	1.5
5	5	5
5	3	4
5	3	4
3	4	3.5
3	5	4
4	3	3.5
1	2	1.5
3	4	3.5
5	4	4.5
1	1	1
4	3	3.5

TABLE D1**Scores of Fraud Cases on a Likert Scale**

emp_fraud	third_fraud	AVERAGE FRAUD
1	2	1.5
2	2	2
3	2	2.5
1	1	1
2	1	1.5
3	2	2.5
3	2	2.5
3	2	2.5
2	2	2
3	2	2.5
2	2	2
2	1	1.5
3	3	3
3	1	2
2	1	1.5
3	1	2
3	3	3
3	2	2.5
3	1	2
2	3	2.5
3	2	2.5
3	3	3
2	2	2
3	2	2.5
1	2	1.5
1	2	1.5
1	2	1.5
2	2	2
1	3	2
2	3	2.5
3	2	2.5
3	3	3
3	3	3
2	2	2
2	2	2
3	3	3
3	2	2.5

2	3	2.5
3	2	2.5
3	5	4
2	2	2
2	4	3
3	1	2
2	5	3.5
3	3	3
2	3	2.5
5	4	4.5
2	5	3.5
4	3	3.5
1	2	1.5
5	3	4
3	2	2.5
3	2	2.5
4	3	3.5

Table E1**Scores of Return on Assets on a Likert Scale**

ROA 2010	ROA 2011	ROA 2012	ROA 2013	ROA 2014	AVERAGE ROA
2	3	2	2	3	2.4
3	2	1	3	3	2.4
2	3	2	2	1	2
3	3	2	3	3	2.8
2	2	3	2	3	2.4
3	3	2	3	3	2.8
3	1	3	3	1	2.2
3	2	3	3	2	2.6
3	2	2	3	2	2.4
3	3	2	3	2	2.6
3	1	1	3	2	2
3	3	3	3	3	3
3	2	2	2	1	2
2	2	3	2	3	2.4
2	3	3	3	3	2.8
1	3	3	2	3	2.4
2	1	3	2	3	2.2
2	2	3	2	2	2.2
2	3	3	2	1	2.2
3	2	2	3	2	2.4
3	2	2	1	3	2.2
3	1	1	2	3	2
3	2	2	2	3	2.4
2	1	3	2	1	1.8
2	3	3	3	3	2.8
3	2	3	3	2	2.6
3	2	2	2	3	2.4
3	2	3	2	3	2.6
1	3	3	3	1	2.2
3	3	2	3	2	2.6
2	3	3	3	3	2.8
2	3	2	3	3	2.6
3	2	3	2	1	2.2
1	3	2	2	3	2.2
2	3	1	3	3	2.4
1	3	3	3	2	2.4
2	3	2	3	3	2.6

1	3	3	2	1	2
3	2	3	2	3	2.6
1	3	1	3	1	1.8
3	3	3	3	2	2.8
1	3	2	2	1	1.8
2	2	2	3	3	2.4
3	2	3	1	1	2
2	2	1	2	3	2
3	2	2	2	1	2
3	2	3	2	2	2.4
1	2	2	2	3	2
2	2	1	2	2	1.8
3	2	3	3	3	2.8
2	2	2	3	1	2
1	2	2	1	2	1.6
3	2	3	3	3	2.8
2	2	2	2	1	1.8