THE EFFECT OF MICROFINANCE INSTITUTIONS' PRODUCTS ON FINANCIAL PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES: A CASE OF MACHAKOS TOWN, KENYA

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DECLARATION AND RECOMMENDATION

Declaration

This Research Project is my own original work and has not been presented for a Degree Qualification in any other University or Institution of learning.

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Recommendation

This Research Project has been submitted for Examination with my approval as the University Supervisor.

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DEDICATION

To the almighty God, my wife Gladys Nyaboke and my daughters Joan Moraa and Celestine Kerubo, for their inspiration, support and encouragement.

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ABSTRACT

Vision 2030 has emphasized the importance of SMEs in Kenya. Small and Medium Enterprises are noted as a crucial catalyst for achieving vision 2030. The research was done on the effects of Microfinance institutions` on financial performance of small and medium enterprises in Machakos town, where the general objective of the research was to determine whether there was any significant effect of Microfinance institutions` products on the financial performance of small and medium enterprises in Machakos town. Descriptive research design was employed since the researcher collected information through descriptions and this design is also useful for identifying variables and hypothetical construction. Stratified random sampling technique was used, and the sample size was determined as 372, at 95% confidence interval. Primary data was collected through questionnaires issued to the owners and managers of SMEs, while secondary data was collected by use of secondary data collection sheet. Both descriptive and inferential statistics were used to analyze data, while correlation and regression were also used to establish the strength of the relationship between microfinance products and financial performance of small and medium enterprises. Statistical Packages for Social Sciences (SPSS) was used by the researcher to facilitate the analysis and interpretation of data, and the results obtained was presented by the use of bar graphs, pie charts, and table for easy interpretation. The results showed that, the MFIs` products offered (micro savings, micro credit and training) had a strong positive correlation on the financial performance of the SMEs, while there was a weak positive correlation between micro insurance and financial performance of the SMEs. The regression analysis indicated that; micro savings, micro credit and micro insurance had significance effect on the financial performance of SMEs, while training had no significance effect on the financial performance of the SMEs. The study recommended that MFIs have a great responsibility of ensuring the proper use of credit which is an important facility in financial performance of businesses. To achieve this, credits should be SMEs-oriented and not product- oriented. Proper and extensive monitoring activities should be provided to SMEs who are granted the micro credit product. MFIs can research into very profitable business lines and offer credit to SMEs who have the capacity to exploit such business lines, micro insurance is paramount to SMEs in cushioning them in the event of unfavorable occurrence, and should be enhanced properly to the SMEs, and that business and financial training should be provided by MFIs on a regular basis and most cases should be tailored toward the training needs of the SMEs.

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LIST OF ABBREVIATIONS

ADAF- Appropriate Development for Africa Foundation

CAMCCUL- Cameroon Cooperative Credit Union League

CIDA- Canadian International Development Agency

GDP- Gross Domestic Product

IMF- International Monetary Fund

MFs- Microfinance

MFIs- Microfinance Institutions

NGOs- Non Governmental Organizations

SHG-Self-Help Groups

SMEs- Small and Medium Size Enterprises

CHAPTER ONE

INTRODUCTION

1.1 Background to the Study

In most parts of the continent of Africa, people are suffering from severe lack of basic needs, and therefore there is need to talk about the need to reduce poverty. The argument behind the introduction of micro finance institutions was to bring people out of poverty and into better living standards with the focus of being able to meet their basic needs. Because the poor will always be with us, it is more attainable and measurable to enable the poor people access the basic needs like shelter, food and water than to simply make a goal of reducing poverty (Yunus, 2007)

Like other countries of the world, SMEs in Kenya have the tendency to serve as sources of livelihood to the poor, create employment opportunities, generate income and contribute to economic growth. They have been seen as the means through which accelerated growth and rapid industrialization have been achieved (Koech, 2011). SMEs have been recognized as socio-economic and political development catalysts in both developed and developing economies (Mwangi, 2011). Maalu, et al. (1999) discussed the role of Small and Medium Enterprises in the economy of Kenya and noted the important role it has played and continues to play, as being employment creation and income generation, the study noted other important roles in the economy such as production of goods and services and development of skills.

The Kenya Government's commitment to foster the growth of SMEs emerged as one of the key strategies in 1986 report. It was reinforced as a priority in 1989 report, a document that set out the mechanisms for removing constraints to growth of MSE sector. In 1992, the government published the MSE policy report. This report was reviewed in 2002, leading to a new policy framework that provides a balanced focus to MSE development in line with the national goals of fostering growth, employment creation, income generation, poverty reduction and industrialization. The overall goal is to, in partnership with the public, private, and development partners, create 500,000 jobs annually over the next four years (a total of 2 million jobs.) The bulky of these jobs are expected to be created in the MSE sector, 88% from the new enterprises and 12% from the growth of existing enterprises (Kenya Agency for the Development of Enterprises and Technology, 2005). The vision 2030 has also emphasized the importance of

SMEs in Kenya. Small and Medium Enterprises are noted as a crucial catalyst for achieving vision 2030.

In practice, most poverty alleviation efforts by states and major development agencies attempt to facilitate take up of an entrepreneurial culture rather than a reliance on relief efforts. Such an orientation to development is driven arguably by several forces: first is that MSEs inevitably form the bulk of economic activity of the poor since these are the forms of affordable engagement. Second, these enterprises are thought to require minimal training to run successfully; although this is debatable. Third and most important, there is a correlation between the existence of MSEs and certain aspects of economic development, particularly employment generation.

Lack of startup capital remains one of the leading barriers to entrepreneurial activity among would-be entrepreneurs in developing economies. Access to affordable training is another. The concept of microfinance, and especially when accompanied by the development of business skills, has evolved as an institutionalized response to this challenge. As micro finance institutions are developing, they are becoming overwhelmingly commercialized. Though commercial MFIs have the most financial support, their desire to profit prohibits them from being as effective as nonprofit organizations that only seek to help the poor.

MFIs in Kenya have a large number of low income households and MSEs in the rural and urban areas of Kenya. MFIs gained prominence in Kenya due to the fact that the formal banking sector since independence up to late 2000 regarded the informal sector as risky and not commercially viable(Kamau,2010). The MFIs developed and offered new, innovative and pro-poor modes of financing low-income households and MSEs based on sound operating principles. Since their inception, MFIs have greatly contributed to social-economic empowerment to the beneficiaries and their dependants (Kamau, 2010).

Various studies conducted on the SMEs in Kenya reveal the influence of microfinance institutions on various aspects of operation of the SMEs. Kiiru(2007) studied on the impact of microfinance institutions on SMEs in Kenya and found out that they had a great impact on employment creation and poverty alleviation. Cooper(2012); Mwangi (2011); Koech(2011) studied on the financial challenges faced by SMEs and found that inadequacies in access to finance are key obstacles to SMEs growth.

Chestone and Kuhn (2002) in a study on the impact of microfinance services on women empowerment found that microfinance has led to expansion of freedom of choice of women. Koech (2011) in a survey of the financial constraints hindering growth of SMEs found that the factors affecting growth were capital market, cost, capital access, collateral requirements, capital management and cost of registration. Coopper (2012) studied on the impact of microfinance services on the growth of SMEs in Nairobi and found a strong positive impact.

As the idea of microfinance continued to spread, so many Microfinance Institutions also began to spring up. According to the Association of Microfinance Institutions in Kenya (AMFI), there are 53 microfinance institutions in Kenya, serving about 6.5 million poor Kenyans. Some are banking institutions, NGOs, Christian Organizations and Non-banking Financial Institutions. They are spread across the whole country. However, with the emergence of many MFIs in Kenya, there seem to be some hope for the poor, who without any extra money, have no possibility to save and accumulate wealth. Poor people aren't always served by banks either because they are not desirable candidates or because they have no money to put into the bank in the first place. If they are able to take a loan from a local bank, they are mandated to pay an interest rate of around 300%. At a rate this high, they can't take out much money and are stuck repaying the interest on the loan rather than using the money they make for economic development. Micro credit was created to combat this issue. First time loans are generally very small, no more than ksh.20,000 or ksh.30,000. They are usually short term loans to be paid back in 3 to 6 months at an interest rate that varies by institution types. When smaller loans are repaid in a timely manner, the borrower builds credit which allows them to take out larger loans to expand their business (Ondoro& Omena, 2012). Many micro finance institutions require their members to save very small amounts of money in their bank before they are allowed to take out a loan. This isn't so they have money to claim as an asset, rather it is to teach them how to save. To improve on the loan repayment by the small and medium enterprises, the microfinance institutions offer training to the businesses to facilitate their operations in term of management skills, record keeping and on marketing. The microfinance institutions in collaboration with insurance companies offer the insurance covers to small and medium enterprises, to cushion them in the event of unfavorable occurrence (Robinson, 2003). Based on this background of the products provided by microfinance institutions to small and medium enterprises, there is need to determine their effect on the financial performance of the small and medium enterprises.

1.2 Statement of the Problem

Accessing products from large and developed financial institutions in the developing economies by SMEs is not easy (Robinson, 2003). World Bank (2000) reiterates the fact that SMEs are more likely to be denied new loans for their businesses than larger firms when in need. They consider SMEs to lack the skills to manage risk and the high transaction costs in lending to them compared to the amount that is borrowed (Hallberg, 2000). This has become the reason for SMEs turning to MFIs for the products which they could have accessed from commercial banks and other large established financial institutions, due to the friendly terms and products tailored to suit the needs of the small and medium enterprises offered by the microfinance institutions.

Various studies have been done in Kenya on small and medium enterprises and microfinance institutions. Kiiru (2007) studied on the impact of microfinance institutions on SMEs in Kenya and found out that they had a great impact on employment creation and poverty alleviation. . Cooper(2012); Mwangi (2011); Koech(2011) studied on the financial challenges faced by SMEs and found that inadequacies in access to finance are key obstacles to SMEs growth. Koech, (2011) in a survey of the financial constraints hindering growth of SMEs found that the factors affecting growth were capital market, cost, capital access, collateral requirements, capital management and cost of registration.

From the above studies, there is a gap that needs to be filled due to the fact that the SMEs use the MFIs` products. There is need to establish whether these products have significant effect on the financial performance of small and medium enterprises, and this study intends to bridge this gap by focusing on the effects of the products provided by microfinance institutions on the financial performance of small and medium enterprises in Machakos town.

1.3 Objectives of the study

1.3.1 General Objective

The general objective of the research was to determine effect of Microfinance's products on the financial performance of small and medium enterprises in Machakos town.

1.3.2 Specific Objectives

The specific objectives of the study were as follows;

(i) To determine the effect of micro savings on financial performance of SMEs.

(ii) To establish the effect of micro credits on financial performance of SMEs.

(iii) To evaluate the effect of micro insurance on financial performance of SMEs.

(iv) To evaluate the effect of training on financial performance of SMEs.

(v) To determine the overall effect of MFIs' products (micro savings, micro credit, micro insurance and training) on financial performance of SMEs.

1.4 Research Hypotheses

Ho1: Micro savings has no significant effect on financial performance of SMEs.

Ho2: Micro credit has no significant effect on financial performance of SMEs.

Ho3: Micro insurance has no significant effect on financial performance of SMEs.

Ho4: Training has no significant effect on financial performance of SMEs.

Ho5: MFIs' products (micro savings, micro credit, micro insurance and training) have no significant effect on financial performance of SMEs.

1.5 Significance of the Study

The findings of this study is useful to the SMEs and especially the ones in Machakos town to be able to utilize the products provided by microfinance institutions in the right way that will enable them to have adequate financial performance. The study will broaden the level of thinking in sourcing capital through financial institutions and develop savings scheme skills for own businesses, thereby broadening the scope and ability to fund own businesses, resulting to improved income hence better financial performance of the SMEs.

Microfinance institutions will benefit from the study by determining how fast they can provide their products and motivation towards spreading their ability in funding the SMEs, thereby justifying their essentiality.

Besides, commercial banks will also get motivated in considering funding the SMEs through the collection of various statistics on their financial performance. Awareness will be created on the challenge facing the SMEs that will lead to creation of a strong capital base which can be invested in other profitable ventures thereby creating employment opportunities and uplifting the economic standards of the SMEs.

The study is also of significance to scholars in contributing knowledge in the field of the effects of MFIs' products on financial performance of SMEs in the county where the study has been carried, given that the SMEs play an important role of poverty alleviation in the country of Kenya.

1.6 Scope of Study

The research was carried in Machakos town for a period of five years, from the year 2008, to 2012, to effectively determine the effects of MFIs` products on the financial performance of SMEs in the town.

1.7Limitations of the Study

The researcher experienced the following limitations for the study:

i. **Issues of confidentiality**

The respondents were reluctant to reveal the contribution of MFIs to their performance for fear of victimisation. To address this, the researcher used a questionnaire to gather information from the respondents. Their identity was anonymous in order to protect their identity and to facilitate gathering of adequate information.

ii. **Negative attitude**

The negative reception of the researcher by some respondents due to the subject of the research prevented the researcher from collecting data from some SMEs. However the researcher managed to control this limitation by seeking the support of the management in collecting data first before distributing the questionnaires.

1.8 Definition of Operational Terms

Micro finance institutions

These are development institutions that grants or provides financial and non-financial products such as small loans, savings, training and micro insurance to low-income persons, and the self-employed people in expanding or establishing their businesses.

Micro financing

This refers to the provision of financial services to low-income persons, and the self-employed people.

SMEs Financial performance

This is the measurement of return on owners' equity of the SMEs in relation to products provided by MFIs, which is measured by net profit divided by capital, multiplied by one hundred.

MFI Products

These are financial and non-financial products (micro savings, micro insurance, micro credit and training), provided by the microfinance institutions to the small and medium enterprises.

Micro Savings are the deposits made of small amounts by SMEs in the MFIs ranging from Ksh. 5,000 to Ksh. 50,000.

Micro Insurance is the insurance covers of less than Ksh. 300,000, provided by the microfinance institutions in collaboration with the insurance companies, to cushion them in the event of unfavorable occurrence.

Micro Credits these are the loans of small amounts advanced by microfinance institutions to small and medium enterprises ranging between Ksh. 20,000 to Ksh. 500,000, to improve their business operations.

Training is the provision of knowledge and skills on management and general operations of the business, by microfinance institutions to small and medium enterprises.

Small and Medium Enterprise

These are enterprises in both formal and informal sector, classified in farm and non-farm categories, employing not more than one hundred employees and have a turnover not more than four million shillings.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter focuses on some of the concepts of microfinance and the role they play in the financial performance of SMEs. The concepts chosen are those that are in relation with the area of this study. The chapter opens with the concept of microfinance, which reviews the evolution of Microfinance in Kenya, and the products they offer. The next centre of attention is SMEs financial performance. This gives an idea of the characteristics, role, contributions and constraints of SME. The nature of microfinance is of importance in getting the services. The chapter concludes with a review on the theoretical links between Microfinance products and SMEs' financial performance.

2.2. The Concept of Microfinance

Microfinance is defined as a development tool that grants or provides financial services and products such as small loans, savings, micro-leasing and micro-insurance to assist the very or exceptionally poor in expanding or establishing their businesses. It is mostly used in developing economies where SMEs do not have access to other sources of financial assistance (Robinson, 2003). In addition to financial intermediation, some MFIs provide social intermediation services such as the formation of groups, development of self confidence and the training of members in that group on financial literacy and management (Ledgerwood, 1999). There are different providers of microfinance (MF) services and some of them are; Non-Governmental Organizations (NGOs), savings and loans cooperatives, credit unions, government banks, commercial banks or non bank financial institutions. The target group of MFIs are self employed low income entrepreneurs who are; traders, street vendors, small farmers, hairdressers and artisans blacksmith (Ledgerwood, 1999).

2.3 Historical Background of Microfinance Institutions

Micro finance is not a new development. The origin of microfinance can be traced back to 1976, when Muhammad set up the Grameen Bank, as experiment, on the outskirts of Chittagong University campus in the village of Jobra, Bangladesh (Yunus, 2007). The aim was to provide collateral free loans to poor people, especially in rural areas, at full-cost interest rates that are repayable in frequent installments. Borrowers were organized into groups and peer pressure among them reduces the risk of default (Khan and Rahaman, 2007).

Zeynep (2006) maintains that micro finance came into being from the appreciation that micro entrepreneurs and some poorer clients can be 'bankable', that is, they can repay both the principal and interest, on time and also make savings, provided financial services are tailored to suit their needs.

Ledgerwood (1999), Christen and Rosenberg (2000) perceive the concept of micro finance as the provision of financial and non financial services by micro finance institutions (MFIs) to low income groups without tangible collateral but whose activities are linked to income generating ventures. These financial services include savings, credit, payment facilities, remittances and insurance. The non-financial services mainly entail training in micro enterprise investment and business skills. Roth (2002) believes that micro finance encompasses micro credit, micro savings and micro insurance.

Webster and Fidler (1996) advocate that in many cases, basic business skill training should accompany the provision of micro loans to improve the capacity of the poor to use funds. Micro enterprise investment training mainly addresses capital investment decisions, general business management and risk management. Capital investment decisions include allocation of the micro enterprise limited capital funds most effectively in order to ensure the best return possible. Therefore, a wrong decision can have long lasting effect not only on the profits but on very survival of the enterprise.

Scott (2003) defines savings as income not spent or differed consumption. The savings mobilization has recently been recognized as a major force in microfinance. In the past, micro finance focused almost exclusively on credit; savings were the "forgotten half" of financial intermediation. The importance of savings mobilization has been highlighted in several papers in the context of micro finance. Microenterprise programs can play a significant role to foster savings among the poor populations, with considerable benefits both for the savings and for the programs. Harper (2003) says that domestic savings provide the assets for the economy's investment in future production. Without them, the economy cannot grow unless there are alternative sources of investment. People's propensity to save varies significantly. Common astuteness states that as a person's disposable income increases, so does his or her capacity and willingness to save.

2.4 Microfinance Institutions` Products

2.4.1 Micro-Savings

Savings mobilization in microfinance is a very controversial issue. They have been increase awareness among policy makers and practitioners on the vast number of informal savings schemes. MFIs such as credit union organizations around the world have been very successful in rallying clients to save (CIDA, 2001). Studies carried out by Cooper (2012) on the impact of microfinance services on the growth of small and medium enterprises in Kenya, found out that savings contributed to the growth of SMEs. Robinson (2003) carried out a study to determine the relationship between micro savings and growth of SMEs. The study, found a positive consistent correlation between micro savings and growth of SMEs. The results from this study therefore supports the assertions that savings with microfinance institutions ensures steady growth of SMEs.

2.4.2 Micro-Credit

These are borrowed funds with specified terms for repayment. People borrow when there are insufficient accumulated savings to finance a business. They also take into consideration if the return on borrowed funds exceeds the interest rate charged on the loan and if it is advantageous to borrow rather than to postpone the business operations until when it is possible to accumulate sufficient savings, assuming the capacity to service the debt is certain (Karlan, 2009). Loans are usually acquired for productivity reasons; that is to generate revenue within a business.

A survey among the entrepreneurs in the SME industry has revealed that there is great reliance on credit as tool for business growth and profitability (Ondoro&Omena, 2012).It is thought that access to credit enables Small and Medium Enterprises to enhance their financial performance (Heidhues,2005). The main objective of microcredit is to improve the performance of SMEs as a result of better access to small loans that are not offered by the formal financial institutions (Navajas, 2010). It is argued that insufficient access to credit by the poor just below or just above the poverty line may have negative consequences for SMEs and overall welfare. Access to low interest credit further increases SME's risk-bearing abilities; improve risk-coping strategies and enables consumption smoothing over time. With these arguments, microfinance lending is assumed to improve the performance of SMEs (Robinson, 2003).

2.4.3 Micro-Insurance

This is one of the services and products that are experimented by MFIs in collaboration with insurance companies. This is based on the premise that the success of the SMEs sector can be aided if a relationship between SMEs and other service providers such as insurance providers is established (Robinson, 2003). In the event that an SME faces a catastrophe like a fire, strike or that its employees are injured at work, they need to have insurance to cover such eventualities as such disasters may leave them vulnerable if they do not have insurance (Manning 2004). MFIs have realized this need and are striving to create a link between the SMEs and the insurance providers. The owners of SMEs need to develop recovery plans in case of an occurrence to the business that is above their control (Robinson, 2003). These strategies should address the safety, health and welfare of employees before, during and after an emergency. Crisis preparedness, response and recovery are essential to help businesses begin to recover and hence perform effectively even in the event of a crisis (Manning 2004). This shows the importance of MFIs in providing a link between SMEs and insurance providers to cover the businesses to ensure recovery and performance in case of a disturbance.

Many group lending programs offer insurance or guarantee scheme as collateral and the Grameen bank is a typical example of MFI in this scheme. One percent of the loan is required to be presented by the group member as their contribution for the insurance for the loan (Ledgerwood, 1999). Empirical studies have found positive relationship between insurance offered by MFIs and the performance of SMEs. For example, Robinson (2003) carried out a study that focused on the influence of MFIs on the performance of SMEs. The study specifically sought to assess the impact of micro-credit on poverty eradication in Zambia also supported the inclusion of micro insurance to increase the performance of small businesses.

2.4.4 Training

Some microfinance institutions provide services such as skills training, marketing, bookkeeping, and production to develop enterprises. Social services such as health care, education and literacy training are also provided by some MFIs and both enterprise development and social services can improve the ability of the low-income earners to operate enterprises either directly or indirectly (Legerwood, 1999). Studies have indicated that training provide knowledge and skills that are necessary for the improved performance of SMES. Cooper (1981) proposes that education and experience were antecedents to the decisions to start a company and ultimately affected performance. Studies have shown that years of formal education of the entrepreneur before starting a new firm were related to eventual performance of the firm (Chi &Lin 2008).

A study by Robinson (2003) that focused on assessing the influence of MFIs products on the performance of SMEs, assessed the contribution of training on the performance of SMEs

2.5 Small and Medium Enterprises in Kenya

The concept of microfinance is not new in Kenya. There has always been the tradition of people saving and/or taking small loans from individuals and groups within the context of self-help to start businesses or farming ventures.

The small and medium Enterprises play an important role in the Kenyan Economy. According to the Economic survey(2006) the sector contributed over 50% of new jobs created in 2005 despite their significance past statistics indicate that three out of five businesses fail within the first few months of operation. Kenya National Bureau of statistics (2009). According to Koech (2011) the factors affecting growth were capital market cost capital account collateral requirements, information access, capital management and cost of capital access is the highest contribution to constraining SMEs financial performance into large businesses. As noted by Amy (2005) one of the most significant challenge is the negative perception towards SMEs. Potential clients perceive small business as lacking the ability to provide quality services and are unable to satisfy more than one critical project simultaneously. Often larger companies are selected and given business for their clout in the industry and name recognition alone.

As with many developing countries there is limited research and scholarly studies about the SME sector in Kenya. The 1999 Baseline Survey conducted by central Bureau of statistics K-rep holdings provided the most comprehensive picture of SME in Kenya. Mead (1998) observes that the health of the economy as a whole has strong relationship with the health and nature of micro and small enterprises sector. When the state of the macro economy is less favorable by contract, the opportunities for profitable employment expansion in SMES are limited. This is true especially for those SME's that have linkages to larger enterprises and the economy at large. Given this scenario an understanding of the dynamics of SMEs is necessary not only has the development of support programmed for SMES but also for the growth of the economy as a whole.

2.6 Determinants of Small and Medium Enterprises' Capital structure

SMEs have some important aspects that are considered when taking decisions on their financial structure. A firm's history is a more important factor in determining the capital structure than its characteristics. The cost of debt to equity is compared; the increase in risk and the cost of equity as debt increases is also compared before taking the decision. The advantage of debt by SMEs due to tax reduction is also considered. The costs of capital remain unchanged when there is a deduction in taxes and interest charges. This indicates that using cheaper debt will be favorable to the business than using equity capital due to increase risk (Modigliani and Miller, 1958 and 1963). Firms would seek a good portion of their capital structure as debt to a certain level so as to take these tax advantages. An over reliance on debt as capital by SMEs will have a negative effect in the business activity in that it will increase the probability of the firm to go bankrupt (Myers, 1984).

Harris, (1990) determines the capital structure of SMEs. The pecking order theory (POT) was used to explain why firms will choose a particular capital structure than the other. The POT stipulates that SMEs average debt ratio will vary from industry to industry because these industries have varied asset risks, asset type and the requirements for external capital (Harris, (1990)). Firms in one industry will have certain aspects that are common to most than to firms in a different industry (Grubes, 2005). The decisions are made taking into consideration information asymmetry, agency theory, and the signaling theory. The signaling theory describes signs and the effectiveness or how a venture will progress in an uncertain environment (Boter, 2005). The main idea behind this theory is that there is an information signal that alerts the stakeholders of what is happening in the business (Scott, 2003). The success of a business in the future is determined by the availability of information to the firm. The stakeholders of a business require signals to find the way of the asymmetry of information between what is known and what is unknown (Wood, 2006). The outsiders get to know about a particular venture based on the signals it sends out. These signals need to be favorable because it is from it that potential investors will be informed and thus show the intention to invest in the venture. The cost of equity will be high when poor signals are noticed by outsiders and this will restrain potential investors (Wood, 2006). Firms get access to venture capital when they have a good goodwill (Zeynep, 2006). Good signals to the outsiders of a firm can be described as equal to due diligence with reduced time and input (Wood, 2006).

New businesses have problems in getting a favourable position in the market. Their existence is determined by their size and age. If it continues to exist, it means it is capable of maintaining its size or it is expanding. This of course goes with time and when they continue to exist, it means resources are acquired or unlimited (Hallberg, 2000). This process of gaining stability and to survive makes the firm to gain legitimacy and thus can be trusted as a successful business since it emits positive signals (Brau, 2004). Firms with unlimited resources at the infancy stage are easy to go bankrupt and die in this early stage (Grubes, 2005). Firms that are young and small are incapable of getting the available resources for the proper functioning of its business activities and they are always associated with external organisations in a vertical manner for support (Boter, 2005). The integration of the young firm with a well established one gains ground for available resources such as funding and legitimacy (Grubes, 2005). Businesses employing this approach to gain legitimacy are at risk since they are not independent. The other activities will have an influence in the outcome of the other. Its competitors along with others get to know the inner dependent firm which the competitor will use it as its strength. They get to know the weaknesses of the opposing firm but at the same time they will enjoy the benefit of transaction cost. The reduction of costs is due to the fact that they integrate with others to realize their objectives. This is done by gaining the inside of the quality of work, production and ideas within its top level.

It is realized that there is no target equity mix and this is due to the fact that they exist two different kinds of equity. The two are at extremes meaning one at the top and the other at the bottom of the pecking order. These differences are caused by the costs of information asymmetry. External sources of funding have more moral hazard problems and consequently the demand for own or internal finances are of paramount to the firm (Grubes, 2005). This moral hazard is explained by the fact that SMEs are very close entities; that is owned and or controlled by one person or few people (Grubes, 2005). POT emphasises on the use of owned capital rather than outside capital by SMEs and also explain why SMEs are denied or has a hindering factor in seeking for external sources of finance. World Bank (2000) reiterates the fact that SMEs are more likely to be denied new loans for their businesses than larger firms when in need. They consider SMEs to lack the skills to manage risk and the high transaction costs in lending to them compared to the amount that is borrowed (Hallberg, 2000).

SME lack managerial skills, resources and experience to motivate the potential investors to invest on them. They view them as high risk business concerns and some well to do SMEs may be hindered critical financing (Bowen, 2009). SMEs and providers of debt and equity need to have a cordial relationship to avoid the problem of information asymmetry and conflicts of interests. All SMEs require financing to grow and the source may be internal or external. The external sources constitute loans, equity infusions, subsidies, or government grants. The internal source is income generated from cash flows that are reinvested. Many SMEs are self –financing by friends and family members at the beginning stage of development but when it gets to a later stage in development, external financing become necessary. Banks find it hard to grant loans to SMEs until when they find it have a stable growth. More so they need to have a track record of their activities, sufficient collateral or adequate guarantees. Businesses that are viable and have good market positions during periods of recession will have difficulties in obtaining bank financing.

Credit availability to SMEs depends on the financial structures in place, legal systems, and the information environment. SMEs in countries with more effective legal system have less financing obstacles since the laws protect property rights and their enforcement are implemented to financial transactions (Boter, 2005)

2.7The Theoretical Framework

2.7.1 Agency Theory

In an agency relationship, one party, called the agent, makes decisions and acts on behalf of another, called the principal. The agency theory attempts to summarize and solve problems arising from the relationship between the SMEs owners and their agents. Agency relationships are common in financial management, due to the nature of the industry (Maria, 2009). When one person manages another person's financial affairs, an agency relationship exists by default. A number of specific agency relationships can exist in the world of financial management. Corporate executives and company shareholders serve as a prime example. CFOs and other financial executives make decisions on behalf of the interests of shareholders, the principals in the relationship. The problem around which the agency theory revolves describes the main challenge of agency relationships: reconciling two distinct sets of personal goals. In an agency relationship, agents are required to work toward meeting SME owner’s goals, yet it is the agents' own goals that drive them to succeed on behalf of the SME owner’s (Karlan& Jonathan, 2009). In order for an agency relationship to be mutually beneficial, both parties' goals must be addressed within a climate of compromise, but with the understanding that meeting the principal's goals is the primary function of the relationship.

To this end, it is vital that information be shared freely and openly between the two parties so agents are always clear on their principals' priorities and principals are always aware of their agents' decisions and actions. Financial management is all about risk, and each investor comes to the table with a different tolerance for risk. In an agency relationship, chances are high that SME owners and their agents have different risk tolerances, which can lead to misunderstandings and a failure to agree on investing decisions (Kiiru, 2007). Even when agents act toward principals' goals, their means of doing so may conflict with principals' risk tolerances. The agents acting for the principals may access the microfinance institutions` products (micro savings, micro credit, micro insurance and training) with a few of enhancing the financial performance of the SMEs, which can lead to misunderstanding and failure to agree with the principal.

2.7.2 Uniting Theory of Microfinance

The uniting theory of micro finance emphasizes on joint liability .Ghatak and Guinnane (1999) reviewed the key mechanisms proposed by various theories through which joint liability could improve repayment rates and the welfare of credit constrained borrowers. They established that all the theories have in common the idea that joint liability can help alleviate the major problems facing lenders i.e. screening, monitoring ,auditing and enforcement by utilizing the local information and social capital that exists among borrowers under explicit joint liability, when one borrower cannot repay a loan, group members are contractually required to repay instead. To improve their performance, the MFIs have made such repayments to be enforced through the threat of common punishment typically the denial of future credit to all members of the defaulting group or by drawing on SMEs' savings funds that serves as collateral. Second, the perception of joint liability can be implicit. That is borrowers believe that if a group member defaults, the whole group will become ineligible for future loan even if the lending contract does not specify this punishment. The uniting theory of microfinance facilitates the repayment of the loans advanced to small and medium enterprises, where the small and medium enterprises take it upon themselves to ensure that the loans advanced to them, either individually or jointly is repaid. The trend on how the loans will be repaid by the SMEs will have a direct influence on further access to the loans from the MFIs, and this will have a positive or negative effect on the financial performance of the SMEs.

2.8 Empirical Studies

Olu (2010) conducted a study on the impact of microfinance on entrepreneurial development of small scale enterprises that are craving for growth and development in a stiffened economy of Nigeria. The study used a questionnaire as an instrument of primary data collection. Tables and simple percentages were used in data presentation. The study revealed that microfinance institutions are evident tools for entrepreneurship development due to the various services they offer and the role they play towards the development of the economy. Not overlooking the various challenges that affect microfinance i.e. operations, the current banking reforms introduced by the Central Bank of Nigeria (C.B.N.) Governor is a welcome development as its employment is set to fortify the microfinance institutions world over and especially in Nigeria are identified to be one of the key players in the financial industry that have positively affected individuals, business organizations, other financial institutions, the government and the economy at large through the services they offer and the functions they perform in the economy. It is expected that with the current reforms put in place by the Federal Government through its regulatory authorities, microfinance institutions in Nigeria will be able to compete favorably in the global market and gainfully increase entrepreneurship development in Nigeria. The study further established that micro finance institutions have a positive relationship with the Nigerian economy represented by the expanded GDP. Although interest rate is not significantly influential, the results of the findings of the study can be summarized that the microfinance institutions and their activities go a long way in determination of the pattern and level of economic activities and development in the Nigerian economy.

Kenei(2011) studied on the impact of microfinance on the development of small scale enterprises, and in his study, the fundamental objective was to assess the impact of microfinance on the development of small and medium enterprises. Simple random sampling technique was employed in his study to select 70 SMEs and 30 MFIs that constituted the sample size of the research. The findings of the study revealed that significant number of the SMEs has the knowledge of the existence of MFIs and some acknowledge positive contributions of MFIs loans towards promoting their growth.

Ngehnvu (2010) also did a research on the Impact of Microfinance Institutions (MFIs) in the Development of Small and Medium Size Businesses (SMEs). The objective was to investigate the impact of Microfinance Institutions (MFIs) in the Development of Small and Medium Size Businesses (SMEs). The project was mainly based on descriptive study since the study was focus on an accurate event trying to answer what, where, how, who and when questions through the use of different sources, information and already existing theories. Looking at the given situation of the research, descriptive approach was used based on the case study of MFIs (CamCCUL) in the development of SMEs in Cameroon. From the information obtained, it was realized that CamCCUL has a positive impact in the development of the members` businesses. CamCCUL provide its members with financial and social intermediation services to help improve their businesses. Securing micro-financing by SMEs was determined by the stage or level of development in which the business was. Businesses that were viewed as growing had it easy to get a loan. But the main criteria used were the ability to pay back and to meet the set requirements to obtain a loan, where the main requirement was fixed tangible assets such as land.

Koech (2011) conducted a study on financial constraints that hinder growth of SMEs in Kenya. The objective of the study was to find out the financial constraints that hinder growth of SMEs. The researcher adapted the case study approach and targeted SMEs in Kamukunji District. The study used structured questionnaires as the tool for data collection. Data was analyzed to obtain percentages and frequency distribution tables. The study found out that the factors affecting/hindering growth of SMEs were identified as capital access, cost, capital market collateral requirements information access, capital management and cost of registration.

Memba et al (2012) conducted a study to establish the impact of venture capital on growth of SMEs in Kenya. The study collected data from SMEs before and after use of venture capital finance. The study established that SMEs made significant growth after accessing the financing and it was argued that lack of finance has been stated as one of the main reasons for SMEs poor performance in most developing countries.

From the above studies, it clear that the studies done have majored on the aspect of micro financing where the microfinance institutions are only regarded as offering only financial services in form of loans to SMEs, leaving out other products which include training, micro credit, and micro insurance. This study therefore fills the gap left on the effects of microfinance institutions' products on financial performance of small and medium enterprises.

2.9 Conceptual Framework

Most poverty alleviation efforts have a bias towards bridging 'the dollar gap' by encouraging entrepreneurial activity. The effects of MFI's products on financial performance of SMEs, and the intervening variables can be demonstrated as shown in the conceptual model below.

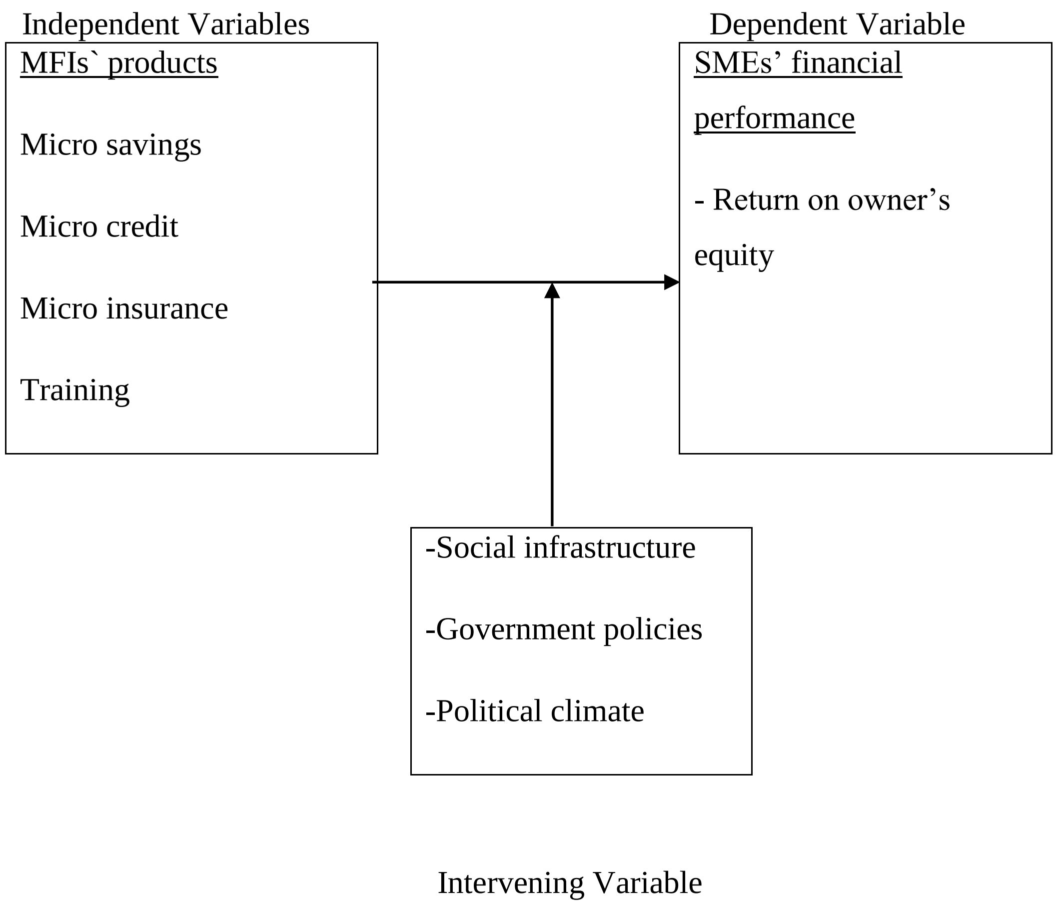

Figure 2.1: Conceptual Framework

In figure 2.1 above, the microfinance products (micro savings, micro credit, micro insurance and training) which were the independent variables , were assumed to have direct relationship with financial performance of small and medium enterprises .The dependent variable, SMEs' financial performance, was measured by return on owner's equity. However, this is not necessarily the case since there are other variables which the researcher may not be able to control (the intervening variables), which were social infrastructure, government policies and political climate.

CHAPTER THREE

METHODOLOGY

3.1 Introduction

In this chapter, the responses to the research questions are described in depth with appropriate explanations. The target population, sampling technique, research design, data collection, research procedure, data analysis is discussed in detail. The research methodology for this study entails the main research methods; quantitative research and qualitative research. The quantitative research method includes correlation analysis and regression analysis of the collected data. On the other hand, the qualitative method includes semi-structured interviews with the various respondents who had interest in the products provided by the microfinance institutions.

3.2 Research Design

Descriptive research design enables an in depth understanding of the variables under study (Cooper and Schindler, 2006). The current study employed a descriptive research design so that the researcher could present each of the independent variables on the effect on the financial performance of the SMEs. The researcher presented the results through tables, pie charts and graph to facilitate the interpretation of data on the relationship between microfinance institutions' products and financial performance of SMEs.

3.3 Population

The target population for the study consisted of the small and medium enterprises in Machakos town which were licensed to operate business in the town as at 31st December 2012, and the number amounted to five thousand, three hundred and eleven SMEs.

Target population

Table 3.1: Target Population

Business Category	Business Code	Population	SME Group
100	110, 115, 120	2439	General Trade, Whole sale stores, personal services
200	205, 210, 215	972	Information sector
300	315, 320, 330, 335, 365, 375, 395	376	Transport, Storage and communication
400	410, 415, 425, 495	128	Agriculture, Forestry and natural resources
500	506, 512, 515, 517, 518, 524, 527, 543, 546, 555	429	Restaurants and accommodation
600	610, 615, 620, 630, 635, 695	576	Professional and Technical services
700	715, 720, 760, 795	180	Private education, health and entertainment services
800	815, 825, 830, 895	211	Industrial plants, factory workshops and contractors
Total		**5,311**	

3.4Sample

Stratified random sampling was employed, since the various types of businesses being carried by the different SMEs were not homogeneous. The researcher grouped the SMEs into strata, and then randomly selected the SMEs from where data was collected. For inclusion in the sample, the SME must have operated for five years. Using Slovin's formula (Ariola et al., 2006), the sample size was determined as 372, at 95% confidence interval.

Slovin's formula is written as:

$n = N / (1 + Ne^2)$ where:

n = Number of samples

N = Total population

e = Error tolerance

Table 3.2: Sample Population

Business Category	Business Code	Population	Sample Size	%per Category
100	110,115,120	2,439	172	46%
200	205,210,215	972	70	18%
300	315, 320, 330, 335, 365, 375, 395	376	26	7%
400	410, 415, 425, 495	128	7	2%
500	506, 512, 515, 517, 518, 524, 527, 543, 546, 555	429	30	8%
600	610, 615, 620, 630, 635, 695	576	41	12%
700	715, 720, 760, 795	180	11	3%
800	815, 825, 830, 895	211	15	4%
Total		**5,311**	**372**	**100%**

3.5 Data Collection

For the purpose of the study, both primary and secondary data was used. The researcher developed a questionnaire as a means of data collection, which was distributed to the owners and managers of the sampled SMEs as the respondents. The distributed questionnaires were collected at a later date to give the respondents humble time to fill in accurately. This instrument of data collection was divided into two sections; first section contains questions on personal data then the business type and size followed by the section on study variables. Secondary data was collected by the use of secondary data collection sheet, where data was obtained from annual financial statements of the sampled SMEs.

The information collected, helped the researcher to fully comprehend the relationship between MFIs' products and financial performance of SMEs.

3.6 Data Analysis and Presentation

In the identification of the main cause of data errors in research especially those that occur when entering data, the unanswered questionnaires were omitted from the study to improve the accuracy of data (Chapman, 2005).

Both descriptive and inferential statistics were used to analyze data, while correlation and regression were also used to establish the strength of the relationship between microfinance products and financial performance of small and medium enterprises.

Statistical Packages for Social Sciences (SPSS) was used by the researcher to facilitate the analysis and interpretation of data, and the results obtained was presented by the use of graphs, pie charts, histograms and table for easy interpretation.

A simple regression model was used to assess the effects of the independent variables (micro savings, microcredit, micro insurance and training) on the dependent variable (financial performance). The following model was used;

$Y = a + \beta 1X1 + \beta 2X2 + \beta 3X3 + \beta 4X4 + \varepsilon$

Where:

Y = Financial Performance

a = Constant

β = Coefficients of variables

X1 = Micro savings

X2 = Micro credit

X3 = Micro insurance

X4 = Training

ε = error term

3.7 Research Validity and Reliability

The degree, to which a test is able to measures what it is required to measure, is the validity. For this research, the data was collected from the SMEs that access products from MFIs so that the researcher would specifically access the effects of the MFIs' products on financial performance of SMEs. Reliability relates to whether similar results can be obtained if another group of respondents were used. The tests for Homogeneity or Internal Consistency were applied by examining the correlation between the individual items which showed high correlation to reflect homogeneity (Burns & Grove, 2001).

CHAPTER FOUR

DATA ANALYSIS, PRESENTATION AND INTERPRETATION

4.1 Introduction

This chapter focuses on analysis, presentation and interpretation of data collected by the study. Out of the 372 questionnaires that were distributed to managers and owners of small and medium enterprises in Machakos town, 343 questionnaires were filled and received from the respondents translating to a response rate of 92.2%. The chapter is broken down into subsections where the first section dealt with respondents' profile while subsequent sections addressed the effects of the MFIs` products on financial performance of SMEs.

4.2 Background Information of the Respondents

4.2.1 Capacity in the business

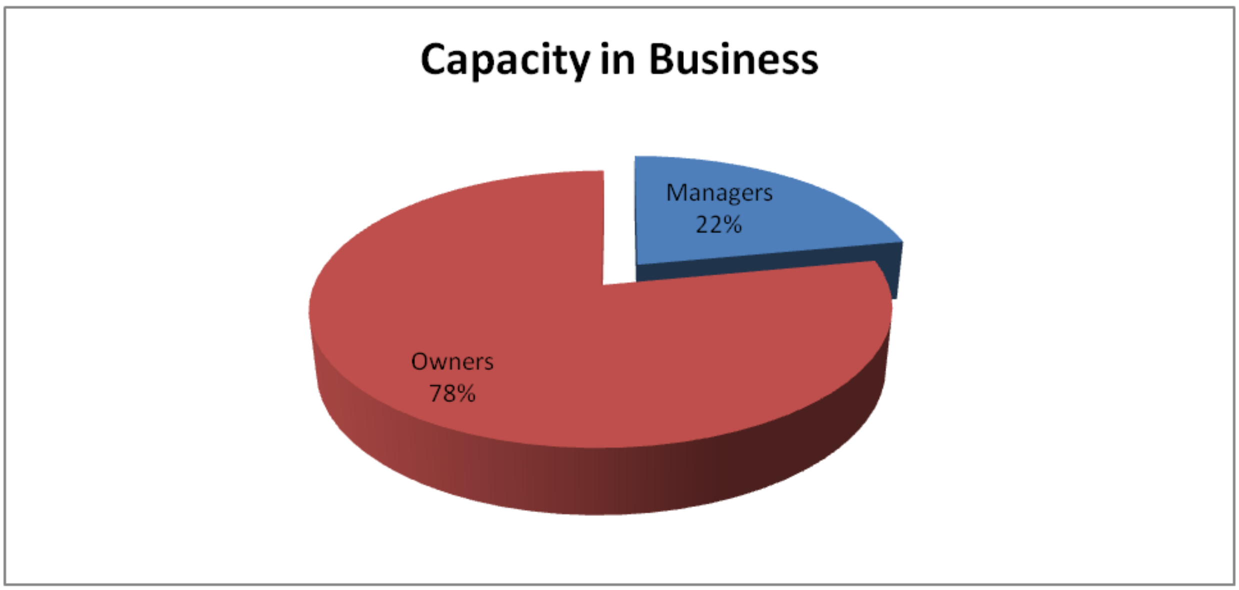

Figure 4.1: Background information

From the above figure, it was observed that the majority of the respondents were owners comprising of 78% while the remaining 22% were managers employed in the businesses. This implies that the small scale businesses are mainly run by the owners themselves as they may not afford to employ managers until they have expanded their businesses.

4.2.2 Nature of Business Category

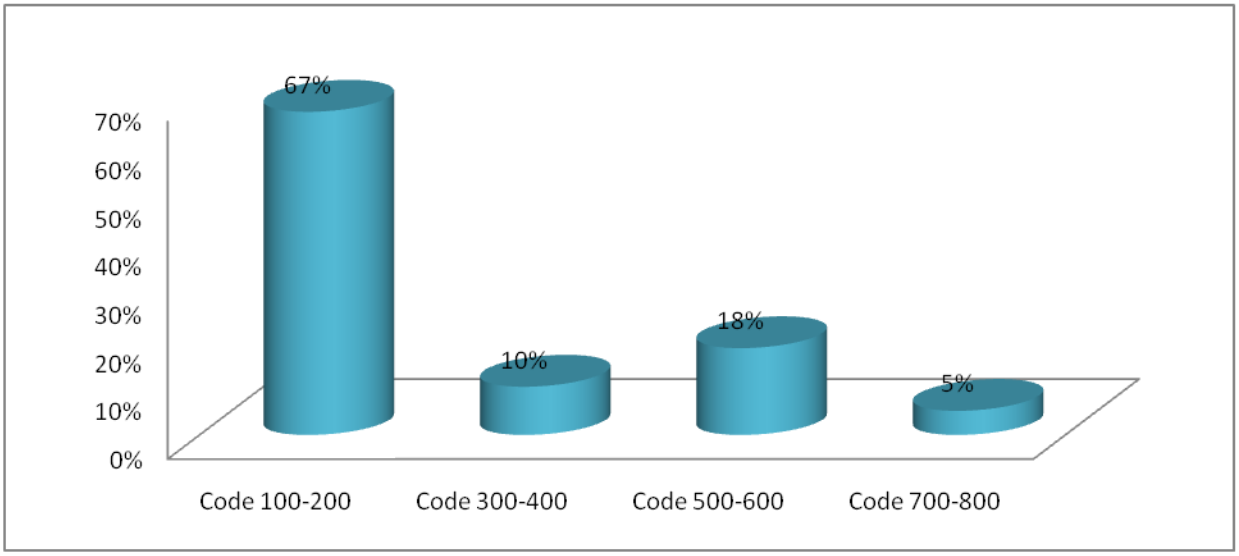

Figure 4.2: Nature of Business

The graph above shows that the businesses with the codes 100 and 200 representing 67% of the total businesses in the town, that participated in the research, implying that the majority of the businesses, constituted kiosks, trader shops, hawkers and small information sector traders. These were followed by the businesses with codes 500 and 600 that represented 18% and these included small and medium lodging hotel, eating houses, night clubs, and professional and technical services. Businesses with codes 300 and 400 represented 10%, and these included small and medium transport companies, petrol filing stations, agriculture producers and dealers. Businesses with codes 700 and 800 made 5%of the sample as indicated on the above figure.

4.2.3 Number of Employees

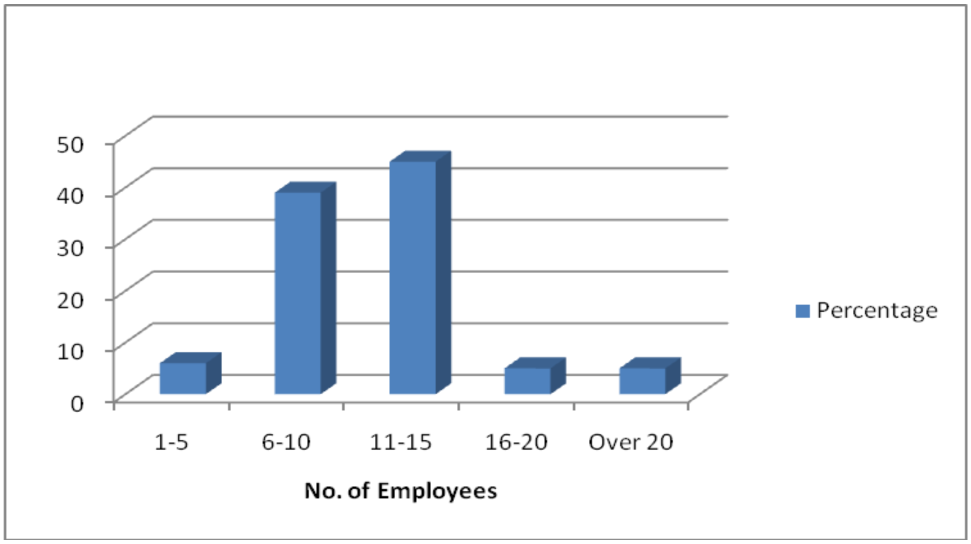

Figure 4.3: Number of employees

The bar graph above shows that 45% of the businesses, had employed between eleven and fifteen employees, followed by the businesses which had between six and ten employees that represend 39% of the respondents. Those that had employees between one and five were 6% of the sample, while those between sixteen and twenty and above twenty, had a 5% each, and this means that most businesses have employees between eleven and fifteen employees.

4.2.3 Number of years in Business

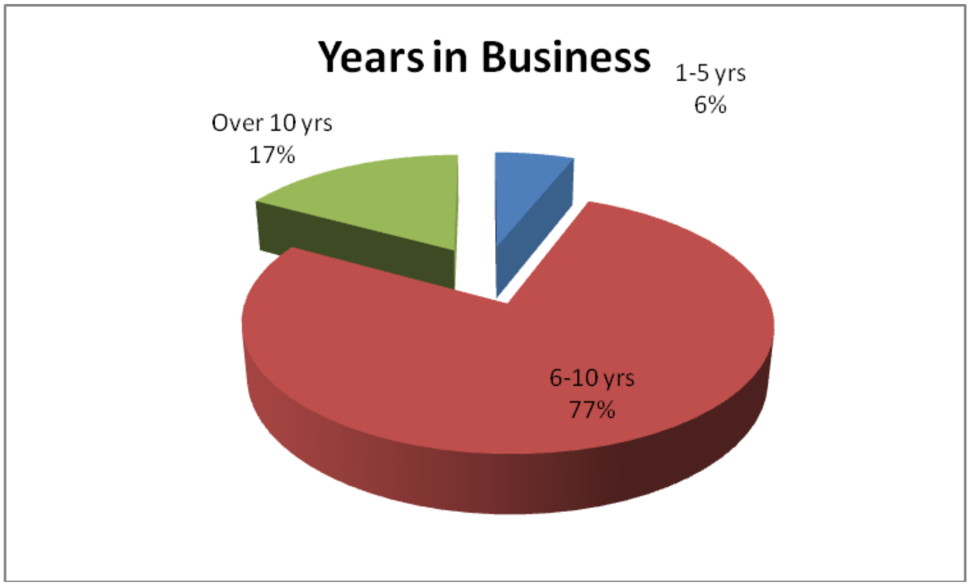

Figure 4.4: Years in Business

From the pie chart above, most of the respondents had been in business between six and ten years representing 77% of the total respondents, followed by those who had been in business for over 10 years representing 17%. Those who had run their businesses for a period of between one and five years represented 6%. Since the majority of the respondents had been in business for over five years, they had more information on the products they have received over the years from the microfinance institutions.

4.3Micro Savings

To evaluate micro savings as one of the products offered by MFIs to the SMEs, respondents were presented with five statements on a five point likert scale and asked to state their agreement with each statement. Responses ranged from 1-Strongly Disagree (SD) through 3-Neutral (N) to 5-Strongly Agree (SA). Both the percentages and mean score for each statement were calculated and the results presented in the table below.

Table 4. 1: Descriptive Statistics for Micro savings

Statements	**Percentages**						
	SD	D	N	A	SA	**Mean**	**Std. D**
The minimum savings allowed by the MFIs is affordable by the businesses.	0	0	30.7	69.3	0	**3.69**	**1.47327**
The interest rate on savings offered by the MFIs is attractive to business.	0	0	30.7	59.4	9.9	**3.79**	**.93752**
The various types of saving accounts offered by the MFIs are necessary to the business.	0	0	8.9	79.2	11.9	**4.03**	**.97952**
Savings through mobile banking allowed by the MFIs is convinient to the business	0	0	60.4	39.6	0	**3.40**	**1.12833**
Micro savings services offered by the MFIs are sufficient to the business.	0	0	1	28.7	70.3	**4.69**	**.85224**

Close to a third of the respondents (30.7%) as shown from the table above neither agreed nor disagreed that the minimum savings allowed by the MFIs is affordable by the businesses, while 69.3% of the respondents agreed with the statement. 30.7% of the respondents neither agreed nor disagreed. 30.7% of the respondents neither agreed nor disagreed that the interest rate on savings offered by the MFIs is attractive to business, while 59.4% agreed with the statement, and 9.9% of the respondents strongly agreed that the interest rate on savings offered by the MFIs is attractive to business. In total 69.3% agreed with the statement. 8.7% of the respondents neither agreed nor disagreed that the various types of saving accounts offered by the MFIs are necessary to the business, while 79.2% agreed with the statement, and 11.9% of the respondents strongly agreed. In total, 91.1% agreed with the statement. 60.4% of the respondents neither agreed nor disagreed that Savings through mobile banking allowed by the MFIs is convinient to the business, while 39.6% agreed with the statement. 1% of the respondents neither agreed nor disagreed that micro savings service offered by the MFIs are sufficient to the business, 28.7% of the respondents agreed and 70.3% strongly agreed with the statement.

From the above table, micro saving services offered by the MFIs are sufficient to the business with the greatest weight, followed by the various types of savings accounts offered with mean scores of 4.69 and 4.03 respectively. It was also observed that, the interest rates on savings followed with a mean score of 3.79. Savings through mobile banking had the least mean score of 3.40, indicating that few people used this technology at the time of the study.

4.4Micro credit

To evaluate Effects of micro Savings on financial performance of the SMEs, respondents were presented with ten statements on a five point likert scale and asked to state their agreement with each statement. Responses ranged from 1-Strongly Disagree (SD) through 3-Neutral (N) to 5-Strongly Agree (SA). Both the percentages and mean score for each statement were calculated and the results presented in the table below.

Table 4.2: Descriptive Statistics for Micro credit

Micro Credit	Percentages						
Statements	**SD**	**D**	**N**	**A**	**SA**	**Mean**	**Std. D**
Delays in loan disbursement reduce the profits of the business	0	0	1	69.3	29.7	**4.29**	**.88364**
Long term loans offered by the MFIs improve the profits of the business	0	0	10.9	79.2	9.9	**3.99**	**1.13500**
Medium term loans offered by the MFIs improve the business profit	0	0	10.9	69.3	19.8	**4.09**	**.81088**
Short term loans offered by the MFIs improve the profits of the business business	0	0	9.9	79.2	10.9	**4.01**	**.67608**
The collateral required for loans by MFIs facilitates additional inventory.	0	0	5.0	90.1	5.0	**4.0**	**.88364**
The rate of interest on loans offered by the MFIs to businesses is too high	0	0	5.9	79.2	14.9	**4.13**	**1.13500**
The mode of disbursement of loans from the MFIs to businesses is convenient.	0	0	10.9	65.3	23.8	**4.08**	**.81088**
The repayment period of loans offered by the MFIs is very short.	0	1.0	19.8	57.4	21.8	**4.00**	**1.12870**
The maximum lending limit offered by the MFIs is appropriate to the business.	0	5.9	21.8	67.3	5.0	**3.71**	**1.11412**

From the above table, 69.3% of the respondents agreed that delays in loan disbursement reduce the profits of the business, while 29.7% of the respondents strongly agreed delays in loan disbursement reduce the profits of the business. Only 1% of the respondents was neither agreeing nor disagreeing. 10.9% neither agreed nor disagreed whether long term loans offered by the MFIs improve the profits of the business. 79.2% agreed that long term loans offered by the MFIs improve the profits of the business, and 9.9% of the respondeds strongly agreed that long term loans offered by the MFIs improve the profits of the business. On whether medium term loans offered by the MFIs improve the business profit, 10.9% of the respondents neither agreed nor disagreed, with 69.3% of the respondents agreeing, and 19.8% strongly agreeing with the statement. Whether short term loans offered by the MFIs improve the profits of the business, 9.9% of the respondents neither agreed nor disagreed, 79.2% agreed and 10.9% of the respondents strongly agreed with this statement. 5% of the respondents neither agreed nor disagreed whether the collateral required for loans by MFIs facilitates additional inventory, while there was 90.1% of the respondents agreeing and 5% of them strongly agreeing with this statement. 5.9% of the respondents neither agreed nor disagreed that the rate of interest on loans offered by the MFIs to businesses is too high, 79.2% of the respondents agreed with this statement, and a further 14.9% of them strongly agreeing. 10.9% of the respondents neither agreed nor disagreed whether the mode of disbursement of loans from the MFIs to businesses is convenient, 65.3% of them agreeing with the statement, and 23.8% of the respondents strongly agreeing with this statement. There were 1% of the respondents who disagreed that the repayment period of loans offered by the MFIs is very short, 19.8% of the respondent neither agreed nor disagreed, 57.4% agreed and a further 21.8% of the respondents strongly agreed with the statement. 5.9% disagreed that the maximum lending limit offered by the MFIs is appropriate to the business, with 21.8% of the respondents neither agreeing nor disagreeing, while 67.3% of the respondents agreed with the statement, and 5% strongly agreeing with the statement.

From the mean weights obtained, it can be observed that delays in loan disbursement reduce the profits of the business had the greatest mean weight of 4.29 followed by the rate of interest on loans offered by the MFIs to businesses being too high with mean score of 4.13. Hence, the main factors on micro savings were delays in loan disbursement and the rate of interest on loans offered by the MFIs to businesses being too high respectively. The maximum lending limit offered by the MFIs as being appropriate to the business had the least mean score of 3.71

4.5Micro insurance

To evaluate on micro insurance, respondents were presented with three statements on a five point likert scale and asked to state their agreement with each statement. Responses ranged from 1-Strongly Disagree (SD) through 3-Neutral (N) to 5-Strongly Agree (SA). Both the percentages and mean score for each statement were calculated and the results presented in the table below.

Table 4.3: Descriptive Statistics for Micro insurance

Effects of micro insurance	Percentages						
Statements	SD	D	N	A	SA	**Mean**	**Std. D**
Insurance covers provided by MFIs are essential to the business	0	0	1	69.3	29.7	**4.29**	**1.20385**
The amount of insurance premiums paid to the MFIs for insurance covers is affordable.	0	1	28.2	70.8	0	**3.68**	**1.14603**
The compensation period for insurance is appropriate.	0	0	10.9	79.2	9.9	**3.99**	**1.04055**

From the table above, 69.3% of the respondents agreed with the statement that insurance covers provided by MFIs are essential to the business, 1% of the respondents, neither agreed nor disagreed, and 29.7% of the respondents strongly agreed that the insurance covers provided by MFIs are essential to the business. 1% of the respondents disagreed that the amount of insurance premiums paid to the MFIs for insurance covers is affordable, with 28.2% of the respondents neither agreeing nor disagreeing, while 70.8% of the respondents agreed with the statement. 10.9% of the respondents neither agreed nor disagreed that the compensation period for insurance is appropriate, but 79.2% of the respondents agreed with the statement, and 9.9% of the respondents strongly agreed with the statement. It is noted from the above table that, the insurance covers provided by the MFIs and the compensation period for insurance, had the highest mean score of 4.29and 3.99 respectively.

4.6Training

To evaluate Effects of training on financial performance of the SMEs, respondents were presented with five statements on a five point likert scale and asked to state their agreement with each statement. Responses ranged from 1-Strongly Disagree (SD) through 3-Neutral (N) to 5-Strongly Agree (SA). Both the percentages and mean score for each statement were calculated and the results presented in the table below.

Table 4.4 Descriptive Statistics for Training

Statements	SD	D	N	A	SA	Mean	Std. D
The frequency of training programs offered by the MFIs is sufficient.	0	0	1	59.4	39.6	**4.39**	**1.11412**
Training on management skills offered by the MFIs is sufficient to the business.	0	0	1	50.5	48.5	**4.48**	**1.22697**
Training on record keeping by the MFIs is essential for the business.	0	0	1	49.7	49.3	**4.48**	**1.03773**
Microfinance Institutions offer training on proper use of their loans.	4.3	5.3	4.6	38.6	47.2	**4.19**	**.91900**
Training on the investment areas by the MFIs increases sales of the business.	1.7	1.7	14.5	59.7	22.4	**4.0**	**1.10884**

Only 1% of the respondents neither agreed nor disagreed that the frequency of training programs offered by the MFIs is sufficient, as shown in the table above, while 59.4% of the respondents agreed with the statement, and a 39.6% of the respondents strongly agreeing with the statement. The above table further shows that 1% of the respondents would neither agree nor disagree that training on management skills offered by the MFIs is sufficient to the business, while 50.5% of the respondents agreed and 48.5% of the respondents strongly agreeing with the statement. On whether training on record keeping by the MFIs is essential for the business, 1% of the respondents neither agreed nor disagreed, 49.7% of the respondents agreeing, and 49.3 strongly agreeing. 4.3% of the respondents strongly disagreed that Microfinance Institutions offer training on proper use their loans, with 5.3% of the respondents disagreeing, whereas 4.6% neither agreed nor disagreed. 38.6% of the respondents agreed with the statement, and 47.2% of the respondents strongly agreed that Microfinance Institutions offer training on proper use of their loans. 1.7% of the respondents strongly disagreed that training on the investment areas by the MFIs increases sales of the business, and an equal percentage of 1.7% disagreed, while 14.5% neither agreed nor disagreed. 59.7% of the respondents agreed that training on the investment areas by the MFIs increases the profits of the business, and 22.4% of the respondents strongly agreed with the statement.

From the above table, training on management skills offered by the MFIs and training on record keeping had equal mean score of 4.48 each, followed by the frequency of training programs offered with a mean score of 4.39. The one which had the least mean score was training on the investment areas, which had a mean score of 4.0.

4.7 Financial performance of the SMEs

To assess financial performance of the studied SMEs, secondary data was used. The researcher collected capital and net profit of the sampled businesses for five years (2008-2012). Return on owner's equity (ROE) was calculated to form the dependent variable (Financial performance of the SMEs) for this study. A summary of the collected data is presented in the tables below;

Table 4.5: Descriptive Statistics for Capital

Year	N	Minimum Capital	Maximum Capital	Mean	Std. Deviation
2008	343	49,000	1,161,000	130,321	9,474.532
2009	343	54,000	1,172,000	132,540	6,867.026
2010	343	56,000	1,183,000	145,216	7,717.311
2011	343	58,000	1,196,000	147,254	6,906.064
2012	343	63,000	1,201,000	151,177	8,437.749
Average	**343**	**56,000**	**1,182,600**	**141,302**	**7,880.54**

Table 4.5 above shows the descriptive statistics for capital employed by the sampled SMEs. Over the years both the minimum and maximum capital is observed to increase from Kshs. 49000 and Kshs.1,161,000 for minimum and maximum respectively in year 2008 to Kshs. 63,000 and Kshs.1,201,000 for minimum and maximum respectively in year 2012. The mean for the SMEs capital in the year 2008 was 130,321, and this improved over the five years to 151,177, while the standard deviation for the five years was between 7,717.311 and 9,474.532, meaning that the variations of capital around the mean was not much over the period under study.

Table 4.6: Descriptive Statistics for Net Profit

Year	N	Minimum Net profit	Maximum Net profit	Mean	Std. Deviation
2008	343	17,000	251,000	150,125	9,355.393
2009	343	21,500	263,000	165,524	8,521.483
2010	343	22,500	271,000	175,201	8,960.038
2011	343	24,000	286,000	181,236	10,698.821
2012	343	27,000	298,000	193,155	12,849.374
Average	**343**	**22,400**	**273,800**	**173,048**	**10,077.020**

Table 4.6 above shows the descriptive statistics for profit obtained by the sampled SMEs. Over the years both the minimum and maximum profit is observed to increase from Kshs. 17,000 and Kshs.251,000 for minimum and maximum respectively in year 2008 to Kshs. 27,000 and Kshs.298,000 for minimum and maximum respectively in year 2012. The mean net profit increased over the five years as shown in the above table, where the mean net profit increased from 150,125 in 2008, to 193,155 in 2012. As observed in the standard deviation, the least mean net profit was 8,521.483 for the five years, and the highest was 12,849.374 in the year 2012, indicating that the mean net profit was fairly stable over the five years under study.

Table 4.7: Descriptive Statistics for ROE

Year	N	Minimum ROE	Maximum ROE	Mean	Std. Deviation
2008	343	18.2%	30.3%	22.4%	3.3%
2009	343	18.7%	38.5%	24.4%	4.1%
2010	343	19.5%	41.2%	25.3%	5.2%
2011	343	21.9%	43.4%	25.8%	3.4%
2012	343	23.3%	43.9%	26.7%	2.7%
Average	**343**	**20.32%**	**39.46%**	**24.9%**	**3.74%**

Table 4.7 above shows the descriptive statistics for ROE calculated from sampled SMEs. Average ROE was observed to increase from 22.4% in 2008 to 26.7% in 2012, with minimal standard deviation over the years, meaning that the average ROE was more stable over the five years under study.

4.8 Correlations Analysis

Table 4.8: Correlations

		ROE	Micro Savings	Micro Credit	Micro insurance	Training
ROE	Pearson Correlation	1	.645**	.674**	.437**	.666**
	Sig. (2-tailed)	.	.000	.000	.000	.000
	N	343	343	343	343	343
Micro Savings	Pearson Correlation	.645**	1	.142*	.145*	.177**
	Sig. (2-tailed)	.000	.	.013	.011	.002
	N	343	343	343	343	343
Micro Credit	Pearson Correlation	.674**	.142*	1	.239**	.060
	Sig. (2-tailed)	.000	.013	.	.000	.302
	N	343	343	343	343	343
Micro insurance	Pearson Correlation	.437**	.145*	.239**	1	.147*
	Sig. (2-tailed)	.000	.011	.000	.	.010
	N	343	343	343	343	343
Training	Pearson Correlation	.666**	.177**	.060	.147*	1
	Sig. (2-tailed)	.000	.002	.302	.010	.
	N	343	343	343	343	343

** Correlation is significant at the 0.01 level (2-tailed).
* Correlation is significant at the 0.05 level (2-tailed).

The above table shows that there is a very strong positive correlation between Micro credit and financial performance of SMEs measured by ROE ($r=0.674^{**}$, $P < 0.01$) followed by training ($r=0.666^{**}$, $P < 0.01$)and then Micro savings ($r = 0.645^{**}$, $P<0.01$) which are statistically significant at 99% confidence level. However, there is a weak positive correlation observed for micro insurance on financial performance of SMEs (r=0.437**, $P < 0.01$). This means that at 1% level of significance, all the above three factors namely: Micro savings, micro credit, micro insurance and training, play a significant role in determining the financial performance of SMEs.

4.9 Regression Analysis

Model summary table below shows the coefficient of determination (R^2) which explains the percentage of the variation in SME Financial Performance.

Table 4.9: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.781[a]	.610	.582	.02779

b. Dependent variable: SME Financial Performance

From the results of the table above, the regression model containing micro savings, micro credits, micro insurance and training as the predictor variables explains 61.0% of the variation in SME Financial Performance while the remainder (39%) can be explained by other factors not included in this model.

The table below displays ANOVA results that test the significance of the R^2 for the model.

Table 4.10: ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	31.687	3	10.562	57.717	.000[a]
	Residual	62.037	339	.183		
	Total	93.724	342			

a. Predictors: (Constant), Micro Savings, Micro Credits, Micro Insurance, Training

b. Dependent Variable: SME Financial Performance

An F statistics of 57.717 with a p-value less than the conventional 5% indicates that the overall model was significant at 95% confidence level.

Table of coefficients below presents the unstandardized and standardized coefficients of the model, the t statistic for each coefficient and the associated p-values. The predictor variables had significant positive relationship with SME Financial Performance except Training.

Table 4.11: Coefficients

Model	Unstandardized Coefficients B	Unstandardized Coefficients Std. Error	Standardized Coefficients Beta	t	Sig.
1 (Constant)	2.286	.344		6.637	.000
Micro Savings	.126	.043	.152	2.957	.003
Micro Credits	.348	.042	.423	8.263	.001
Micro Insurance	.115	.040	.169	2.892	.004
Training	.009	.049	.009	.187	.851

a. Dependent Variable: SME Financial Performance

The findings confirm that there is a statistically significant influence of micro savings, micro credits and micro insurance on SME Financial Performance. On the contrary, training was not significant at 95% confidence level. This implies that unit increase in micro savings, micro credits and micro insurance leads to a significant increase in SME Financial Performance as demonstrated by the equation below;

SME Financial Performance = 2.286 + 0.126Micro Savings + 0.348Micro Credits + 0.115Micro Insurance

From the significance column of the provided table, at 5% level of significance, it was observed that micro savings, micro credit and micro insurance are the main variables that explain the variance in financial performance of SMEs. From the above regression equation, a unit increase in micro savings leads to a 0.126 increase in financial performance, a unit increase in micro credit leads to a 0.348 increase in financial performance and a unit increase in micro insurance leads to a 0.115 increase in financial performance.

4.10 Testing hypothesis

The first hypothesis H_o1: Micro savings has no significant effect on financial performance of SMEs. The null hypothesis that Micro savings has no significant effect on financial performance of SMEs was tested at 5% significant level. This hypothesis was rejected at 5% since the p-value=0.003 was less than 5% with t=2.957.

The second hypothesis H_o2: Micro credit has no significant effect on financial performance of SMEs. The null hypothesis that Micro credit has no significant effect on financial performance of SMEs was tested at 5% significant level. It was then rejected at 5% significant level p-value=0.001 which is less than 5% with t=8.263.

The third hypothesis H_o3: Micro insurance has no significant effect on financial performance of SMEs. The null hypothesis that Micro insurance has no significant effect on financial performance of SMEs was tested at 5% significance level. It was then rejected since p-value=0.004 was less than 5% with t=2.892.

The fourth hypothesis H_o4: Training has no significant effect on financial performance of SMEs, was accepted since the p-value=0.851 was greater than 5% significant level with t=.187. It was therefore accepted that at 5% significant level, Training has no significant effect on financial performance of SMEs.

In conclusion the hypothesis that MFIs` products have no significant effect on financial performance of SMEs was rejected since most of the predictor variables of the model, micro savings, micro credit and micro insurance, were significant, though one of the predictor variables training, was not significant at 5% significant level.

CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter presents the summary of the main findings, study conclusions and gives recommendations. The main objective of this study was to determine whether there was any significant effect of Microfinance's products on the financial performance of small and medium enterprises in Machakos town. Specifically, the study sought to determine the effects of micro savings on financial performance of SMEs, to establish the effects of micro credits on financial performance of SMEs, to evaluate the effects of micro insurance on financial performance of SMEs, to assess the effects of training on financial performance of SMEs, to determine the overall effects of MFIs' products on financial performance of SMEs, and to give relevant recommendations from the above objectives.

5.2Summary of Findings

Based on the mentioned objectives of the study in the introduction above, the following are the summary findings of the results obtained from the data analyzed;

5.2.1Effects of Micro Savings on Financial Performance of SMEs

The first objective sought to determine the effects of micro savings on financial performance of SMEs. From the results, it was observed that Micro savings service offered by the MFIs were sufficient to the SMEs. The various types of saving accounts offered by the MFIs were found to be necessary to the SMEs. Further to these, the interest on the various savings was found to be attractive to the SMEs. The results showed that at 5% level of significance, Micro Savings played a significant role in determining financial performance of SMEs in Machakos town, where a unit increase in micro savings led to 0.126 increase in financial performance. The corretion analysis findings indicated a positive relationship between micro savings and financial performance. The study therefore rejected the null hypothesis that micro savings has no significant effect on financial performance of SMEs. These findings support those of Cooper (2012) who carried out a study on the impact of microfinance services on the growth of small and medium enterprises in Kenya, and found out that savings contributed to the growth of SMEs.

5.2.2 Effects of Micro Credit on Financial Performance of SMEs

The second objective sought to determine the effects of micro Credit on financial performance of SMEs. From the results, it was observed that the delays in loan disbursement reduce the profits of the SMEs. The rate of interest on loans offered by the MFIs was too high to the SMEs, because the various types of loans attract different rates of interest. The results showed that at 5% level of significance, Micro Credit played a significant role in determining financial performance of SMEs in Machakos town, where a unit increase of micro credit leads to 0.348 increases in financial performance of the SMEs. The correlation analysis findings indicated a positive relationship between micro Credit and financial performance. The study therefore rejected the null hypothesis that Micro credit has no significant effect on financial performance of SMEs. These results support those of (Ondoro and Omena, 2012) who documented that there is great reliance on credit as tool for business growth and profitability in a survey among the entrepreneurs in the SME industry. The findings also support those of Heidhues (2005) who explained that access to credit enables Small and Medium Enterprises to enhance their financial performance.

5.2.3 Effects of Micro Insurance on Financial Performance of SMEs

The Third objective sought to determine the effects of micro Insurance on financial performance of SMEs. From the results, it was observed that the insurance covers provided by the MFIs were essential to the SMEs. The amount of insurance premiums paid to the MFIs were affordable as found out, and also the compensation period for the insurance was found to be appropriate. Micro Insurance from the results above at 5% level of significance, had a significant effect on the financial performance of SMEs in Machakos town. From the regression analysis, the hypothesis that Micro insurance has no significant effect on financial performance of SMEs was tested at 5% significant level. It was observed that, Micro insurance had a significant effect on financial performance of SMEs; thus, the null hypothesis was rejected. These findings support those of Johnson (2000) who associated micro insurance to increase in the performance of small businesses in his study carried out to assess the impact of micro-credit on poverty eradication in Zambia.

5.2.4 Effects of Training on Financial Performance of SMEs

The fourth objective sought to determine the effects of Training on financial performance of SMEs. It was observed that training on management skills was sufficient and training on record keeping was adequate. The frequency of the training programs offered by MFIs was also found to be sufficient. From the regression analysis, the hypothesis that training has no significant effect on financial performance of SMEs was tested at 5% significant level. It was observed that, training did not have a significant effect on the financial performance of SMEs; thus, the null hypothesis was accepted. These findings supported those of (Legerwood, 1999) who documented that social services such as health care, education and literacy training are also provided by some MFIs and both enterprise development and social services can improve the ability of the low-income earners to operate enterprises either directly or indirectly. However, the study contradicted that of Chi & Lin (2008) who reported a significant relationship between training and the performance of SMEs.

5.3 Conclusion

The product with most significant effect on the SMEs` financial performance is micro credit, where the main factors considered were loan disbursement, then the interest on loan offered and the types of loans offered. The second product which had also significant effect is micro savings, where the micro savings services were sufficient, and the various savings accounts are necessary. Micro insurance became third as having significant effect on the MSEs financial performance, where the insurance covers and the compensation period were essential and appropriate. Training was found to have no significant effect on financial performance, though training on record keeping and training on management skills by the MFIs, were considered to be important.

5.4 Recommendations

In view of the findings made and conclusions drawn from the study, the following recommendations are provided to help enhance an accelerated and sustained financial performance in the SME sector

The MFIs have a great responsibility of ensuring the proper use of credit which is an important facility in financial performance of businesses. To achieve this, credits should be SMEs-oriented and not product- oriented. Proper and extensive monitoring activities should be provided to SMEs who are granted the micro credit product. MFIs can research into very profitable business lines and offer credit to SMEs who have the capacity to exploit such business lines.

Basing on the current trends in business, the micro insurance is paramount to SMEs in cushioning them in the event of unfavorable occurrence, and should be enhanced properly to the SMEs.

The researcher recommends that business and financial training should be provided by MFIs on a regular basis and most cases should be tailored toward the training needs of the SMEs.

5.5Areas for Further Research

The growth of SMEs in Machakos town is slow despite of the existence of MFIs in the area, with the many products they offer. The concern therefore is on what factors influence the growth of SMEs in the town? This is an area that needs further detailed research.

Whereas this research has relied on quantitative approaches to examine effect of Microfinance's products on the financial performance of small and medium enterprises, an in-depth analysis of individual responses can generate useful inductive information and provide a richer understanding of the effect of Microfinance's products on the financial performance of small and medium enterprises.

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APPENDICES

Appendix I: Questionnaire

<u>Instructions</u>

Kindly follow the following instructions while filling the form.

(i) Do not write your name in this questionnaire.

(ii) Respond by ticking the correct choice.

(iii) Identify the right place to fill as manager or the owner of the small or medium enterprise.

Kindly, respond to the following questions as honest and accurate as possible. The information you give will be useful for the purpose of this research <u>only</u> and will be treated with the confidentiality it deserves.

PART 1

SECTION A: BACKGROUND INFORMATION

Tick (√) the appropriate option.

1. What is your capacity in the business?

(a) Owner ( ) (b) Manager ( )

2. What is the nature of the business category?

(a) 100 - 200 ( ) (b) 300- 400 ( ) (c)500- 600 ( ) (d) 700 ( ) (e) 800 ( )

3. How many employees does the business have?

(a) 1- 5 ( ) (b) 6 - 10 ( ) (c) 11 – 15 ( ) (d) 16 – 20 ( ) (e) Over20 ( )

4. How many years has the business been in operation?

(a) 1 – 5 years ( ) (b) 6 – 10 years ( ) (c) Over 10 years ( )

SECTION B: MICROFINANCE INSTITUTIONS` PRODUCTS

Please tick in one of the boxes, the extent to which you agree with the following statements;

a. Micro Savings

(1)	(2)	(3)	(4)	(5)
Strongly disagree	Disagree	Neither	Agree	Strongly agree

	1	2	3	4	5
5. The minimum savings allowed by the MFIs is affordable by the businesses.					
6. The interest rate on savings offered by the MFIs is attractive to business.					
7. The various types of saving accounts offered by the MFIs are necessary to the business.					
8. Savings through mobile banking allowed by the MFIs is convinient to the business					
9. Micro savings services offered by the MFIs are sufficient to the business.					

b. Micro Credit

(1)	(2)	(3)	(4)	(5)
Strongly disagree	Disagree	Neither	Agree	Strongly agree

	1	2	3	4	5
10. Delays in loan disbursement reduce the profits of the business					
11. Long term loans offered by the MFIs improve the profits of the business					
12. Medium term loans offered by the MFIs improve the business profit					
13. Short term loans offered by the MFIs improve the profits of the					

business business					
14. The collateral required for loans by MFIs facilitates additional inventory.					
15. The rate of interest on loans offered by the MFIs to businesses is too high					
16. The mode of disbursement of loans from the MFIs to businesses is convenient.					
17. The repayment period of loans offered by the MFIs is very short.					
18. The maximum lending limit offered by the MFIs is appropriate to the business.					

c. Micro Insurance

(1) Strongly disagree (2) Disagree (3) Neither (4) Agree (5) Strongly agree

	1	2	3	4	5
19. Insurance covers provided by MFIs are essential to the business					
20. The amount of insurance premiums paid to the MFIs for insurance covers is affordable.					
21. The compensation period for insurance is appropriate.					

d. Training

(1) Strongly disagree (2) Disagree (3) Neither (4) Agree (5) Strongly agree

	1	2	3	4	5
22. The frequency of training programs offered by the MFIs is sufficient.					
23. Training on management skills offered by the MFIs is sufficient to the business.					

24. Training on record keeping by the MFIs is essential for the business.					
25. Microfinance Institutions offer training on proper use of their loans.					
26. Training on the investment areas by the MFIs increases sales of the business.					

Thank you for participation

Appendix II: Secondary Data Collection Sheet

Business Code	Capital (Ksh)	Net Profit (Ksh)	ROE (%)

Appendix III: Number of SMEs in Machakos town, as at 31st December 2012

Business Category	Business Code	Business Description	Total
100	110	Medium Trader Shops and Retail Services	423
	115	Small Trader Shops and Retail Services	1849
	120	Kiosks	167
200	205	Hawkers with Motor Vehicles	7
	210	Hawkers without Motor Vehicles	140
	215	Small Information Sector Trader/Service Provider	825
300	315	Small Transport Company	30
	320	Independent Transport Operators	303
	330	Medium Petrol filling Stations	8
	335	Small Petrol filling Stations	3
	365	Small Storage Facility	11
	375	Medium Communication Company	1
	395	Micro Transport Storage and Communication	20
400	410	Medium agricultural producer,processor/Dealer/Export	2
	415	Small agricultural producer, processor/Dealer/Export	112
	425	Medium natural resources extraction operation	1
	495	Micro agricultural forestry and natural resources	13
500	506	Medium High standard Lodging Hotel D class	1
	512	Medium Eating Houses/Snack Bar, Tea House	22
	515	Medium Lodging Hotel with Restaurant/Bar B/C class	3
	517	Small Night Clubs/Casino	3
	518	Small Lodging House with Restaurant or B/C class	16
	524	Medium Lodging House B/C class	6
	527	Small Lodging Houses	26
	543	Medium Restaurant with Bar/Membership club	22
	546	Medium Restaurant with bar (10 customers)	70
	555	Small eating Houses	260
600	615	Small Professional Services	27
	620	Independent Technical operator	179
	630	Medium Financial Services	15
	635	Small Financial Services	17
	695	Other Professional and Technical Services	338
700	715	Medium Private Educational Institutions	21
	720	Small Private Education Facility	119
	760	Small Entertainment Facility	1
	795	Other Educational, Health and Entertainment Services	39
800	815	Small Industrial Plants	2
	825	Medium Workshops/Service Repair Contractor	11
	830	Small Workshops/Service Repair Contractor	178
	895	Other Manufacturers, Factory and Contractors	20
	Total		**5,311**

Source (Municipal Council of Machakos; Licensing department)