EFFECTS OF MICRO-FINANCE SERVICES ON THE PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES PERFORMANCE IN NAKURU TOWN

NOELA JEPKORIR KIPSANG

A Research Project submitted to the School of Business & Economics in partial fulfillment for the award of the Degree of Master in Business Administration [Finance Option], of Kabarak University

KABARAK UNIVERSITY

NOVEMBER, 2016

DECLARATION

This project is my original work and has not been presented for a degree in any other University.

Student: Noela Jepkorir Kipsang

Student Signature: _____

Admission Number: GMB/NE/0183/01/14

Date: _____

RECOMMENDATION

To the Institute of Postgraduate Studies:

The project entitled "Effects of Micro-Finance Services on the Performance of Small and Medium Enterprises Performance in Nakuru Town" and written by Noela Jepkorir Kipsang is presented to the Institute of Postgraduate Studies of Kabarak University. We have reviewed the research project and recommend it be accepted in partial fulfillment of the requirement for the degree of **Masterof Business Administration.**

_____

Ms. Stella Korir
Lecturer, School of Business and Economics
Kabarak University

_____

Dr. Joel Koima
Lecturer, School of Business and Economics
Kabarak University

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DEDICATION

I dedicate this work to my loved ones Cherise, Allan and everyone else who dedicated his or her

time to support me .

ABSTRACT

The purpose of this study was to investigate the effects of micro-finance funding on the performance of small and medium enterprises within Nakuru town. More specifically, the study sought to analyze the effect of MFI's cost of credit on the performance of SMEs, to determine the effect of non-repayment of MFI's loans on the performance of SMEs and to evaluate the effect of trainings offered by MFIs on SMEs' performance in Nakuru town. The population of the study was 84 SME's owners and the researcher employed a census sampling method. To achieve the objectives of the study, a survey design was employed. The consistency of the study results were measured using test- retest reliability whereby the same group of respondents will be used repeatedly to test whether the same results could be obtained. The content validity will be ascertained by the researcher in consultation with the supervisors and expert opinion from them. The study relied principally on primary data which was collected using questionnaires containing mainly closed ended questions for ease of analysis. The study employed an exploratory survey study design which sought to collect data without manipulating the research descriptive study variables or the respondents in an attempt to get the perception of the respondents on the effects of micro-finance funding on the performance of small and medium enterprises. This study targeted SME's shops funded by MFIs within Nakuru town and used a census sampling method because the target population was small.Data was analyzed using descriptive and inferential statistics with the aid of Statistical Package for the Social Sciences (SPSS). Findings indicated that $r^2 = 0.638$, which means that 63% of the total variation in dependent variable can be explained by the linear relationship between x and y. Correlation analysis results revealed cost of credit($r=0.670$, $\alpha = 0.01$), non-payment ($r = 0.590$ $\alpha = 0.01$) and training ($r = 0.621$ $\alpha = 0.01$) had an influence on increase in performance with a positive and significant relationship. It can therefore be concluded that all the variables were significant to the study problem although the degrees of influence varied. Based on the findings, the study concludes that the performance is due to changes in cost of credit, on-repayment of loans and training provided by MFIs. The results show the relationship between the micro finance services and the growth of SMEs. There is a strong positive relationship between the micro finance services and the SMEs Growth. The study further concludes that Microcredit and Training provided to SMEs leads to their high growth. Since the study focused on micro finance services on the performance of SMEs in Nakuru County, it is suggested that further studies be done on other Counties. This is because different counties have unique characteristics and diverse contextual realities that might affect micro finance services offered to SMEs. This study will be of benefit to the small and medium enterprises because they will be able to use the results of this study to overcome the challenges that might be preventing them from stabilizing their businesses. Since the study focused on micro finance services on the performance of SMEs in Nakuru County, it is suggested that further studies be done on other Counties. This is because different counties have unique characteristics and diverse contextual realities that might affect micro finance services offered to SMEs

Key words: Micro-Finance, Small and Medium Enterprises.

TABLE OF CONTENTS

ACRONYMS & ABBREVIATIONS

GDP :   Gross Domestic Product

MFIs :   Micro Finance Institutions

NGOs :   Non-Governmental Organizations

SACCOs :   Savings and Credit Cooperatives

SMEs :   Small and Medium Enterprises

UNDP :   United Nations Development Programme

WIP :   Work In Progress

LIST OF TABLES

LIST OF FIGURES

CHAPTER ONE

INTRODUCTION

1.1   Background of the Study

Microfinance refers to a variety of financial services that target low-income clients, particularly women. (Hospes, 2004). Since the clients of microfinance institutions (MFIs) have lower incomes and often have limited access to other financial services, microfinance products tend to be for smaller monetary amounts than traditional financial services. These services include loans, savings, insurance, and remittances. Microloans are given for a variety of purposes, frequently for microenterprise development. The diversity of products and services offered reflects the fact that the financial needs of individuals, households, and enterprises can change significantly over time, especially for those who live in poverty. He also points out that because of these varied needs, and because of the industry's focus on the poor, microfinance institutions often use non-traditional methodologies, such as group lending or other forms of collateral not employed by the formal financial sector.

Small and Medium Enterprises (SMEs) have started flourishing because of the favourable business climate that has been created by the Microfinance Institutions (MFIs). The performance of SMEs have tremendously improved as a result of funding that MFIs have been injecting into the sector through the loans that do not have stringent conditions and low interest rates attached to the facilities being made available to the SMEs. The loans that MFIs have been lending to the small businesses have positively changed many enterprises' performance. Many enterprises have been able to make business ventures that have earned them a lot profits. (Nchari, 2006). There are reports that some SMEs that were funded by MFIs have turned out to be big financial institutions competing with renowned financial institutions both locally and internationally. The business activities that are carried out

include hotel operators, shop stalls selling a variety of products such as clothes and shoes, electronics and others started as small microfinance institutions and have turned out to be renowned banks competing with other performing banks in the financial markets.(Croffie&Okraku, 2007).

Microfinance is the provision of financial services to low-income clients or solidarity lending groups including consumers and the self-employed, who traditionally lack access to banking and related services, (Armendariz&Morduch, 2010). MFIs have played a crucial in the financing the SMEs. Many entrepreneurs have been able to start their businesses because of the financial support that the microfinance institutions have been offering them. MFIs have also been involved in other activities that have been geared towards helping the SMEs to effectively run their businesses. Some of these programs include the managerial and advisory services that are usually offered in form of training and seminars. The SMEs are trained on how to manage their enterprises in professional ways that can lead to the enterprises realizing their business objectives. The MFIs also carry out market research to get important information they can give to the entrepreneurs on the best ways they can operate their businesses profitably. They usually advise the SMEs before they can give them finance for their enterprises, (Barbara, 2009).

Globally, SMEs funded by MFIs have been growing and have stabilized financially. The SMEs funded by MFIs in these countries have had enough support from their governments. There has been legal recognition for microfinance institutions (MFIs), regulatory and supervisory capacity for microcredit and other microfinance services, deposit policies, accounting transparency, client protection, credit bureaus and political stability. The countries of East and South Asia are rated as having the most favorable conditions for microfinance

operations. The SMEs funded by MFIs in in Pakistan and Philippines have been reported as the most performing SMEs in the world. These SMEs started with little capital that was given unto them in form of loans that do not have stringent conditions and also characterized by no collateral or security to obtain these loans, (Zeller , 2003). Buckley, (2007) reported that SMEs funded by MFIs have grown tremendously in China in the recent past. The performance of these SMEs has been good and their capital bases have stabilized to a state where these SMEs can finance their businesses. This has been attributed to the new regulatory limits on interest rates and lending margins that are favourable to the SMEs that the government of China is implementing. These regulations have made SMEs in China to have easy access to the finances for their enterprises.

There is a growing number of SMEs funded by MFIs in Africa in the last decade. Many African governments have realized the importance role SMEs play in provision of employment for the large number of unemployed population which is a characteristic of the African nations. Many of these countries are now involved in the processes of drafting policies that will create a favourable entrepreneurial environment for the growing number of SMEs and MFIs. In Nigeria, for instance, SMEs funded by MFIs has been seen as an engine of economic growth and for promoting equitable development. SMEs in Nigeria have benefitted from financial support from MFIs and have been able to improve their production. Some of these SMEs in Nigeria started with small working capital selling their products locally, but their market base have grown to include exports to the neighboring countries and also the continent of Europe. A good example is the Egoro Textile enterprise which has expanded its sales of textile products to Ghana, Guinea, Ivory Coast, Albania and Bosnia, (Mosley, 2008).

Kenya like many other developing countries has many microfinance institutions. The World Bank (2013) estimates that there are about 10000 institutions worldwide with over 30 in Kenya and this number serve a huge population estimated to be about 40 million. A well-managed microfinance institution can generate a significant return in investment. It was estimated in 2013 by the World Bank that about 7 billion dollars is handled by microfinance worldwide. About 80% of Kenyans live below the poverty line with less than 2 dollars a day (World Bank, 2013). Those people who live below the poverty line lack adequate means to have access to financial services in conventional financial institutions. Their only solution as of then was traditional money lenders who charged astronomical interest rates. As a matter of fact Microfinance became the only formal financial institution that can lend money to them. (Mjomba, 2011).Few studies have been done in Kenya revolving around microfinance.There has been a growing number of SMEs funded by MFIs in Kenya in the last ten years. The government of Kenya has realized the important role that the SMEs and MFIs play in reducing the unemployment rate in the country. The importance of microfinance to entrepreneurial development has made the Central Bank of Kenya adopted it as the main source of financing entrepreneurship in Kenya. The performance of the SMEs has improved tremendously because of the financial support that the MFIs are providing. Apart from providing financial assistance to the SMEs microfinance institutions such as Faulu Kenya and Kenya Women Finance Trust have been involved in other activities such as managerial and advisory services, training and other technical services to the SMEs.(Montogometry, 2005).

1.2   Statement of problem

The micro finance industry in Kenya has experienced rapid growth over the years in an attempt to meet the large demand of credit from the large of Kenyans lacking access to financial services (www.knbs.or.ke.). According to Pederson,(2003), Small and Medium

Enterprises (SMEs') face challenges in obtaining funds from large and formal financial institutions which involve a tedious process thus opt for loans from micro-financial institutions to fund their business projects. He indicates that the MFIs should provide liability products so that SMEs can get secure savings as well as more control over funding and asset liability management for them. This should consequently improve the performance of SMEs' by making them to expand their businesses from saving and also acquiring huge loans and thus stabilize and expand the scale of operation. However, despite of a tremendous growth in the number of SMEs in Kenya funded by MFI, the majority of these SMEs have not improved on their performance. Weldern, (2002).Many SMEs funded by MFIs have collapsed within their first year of starting operations. The collapse of these MFIs has been attributed to poor business plan and lack of proper feasibility study report of the business environment. Most SMEs have been reported to have made insignificant progress in their performance, (Betty, 2006). She also points out that there are some MFIs that have registered significant growth and expansion of their operations. In Kenya, as elsewhere, there is a dearth of empirical research investigating the relationship between training and SME performance. This study sought to close the information gap by providing empirical evidence on the relationship between training and performance in small and medium enterprises in Nakuru. This research study therefore sought to establish effects of MFIs services on the performance of SMEs within Nakuru town.

1.3   Objectives of the Study

The purpose of this study was to investigate the effects of MFIs services on the performance of SMEs within Nakuru town.

The following specific objectives will be advanced:

i.   To analyze the effect of MFI's cost of credit on the performance of SMEs in Nakuru town.

ii.   To determine the effect of non-repayment of MFI's loans on the performance of SMEs in Nakuru town.

iii.   To evaluate the effect of trainings offered by MFIs on SMEs' performance in Nakuru town.

1.4   Research Questions

i.   What is the effect of MFI's cost of credit on the performance ofSMEs in Nakuru town?

ii.   How has non-repayment of MFI's loans affected the performance of SMEs in Nakuru town?

iii.   What is the effect of trainings offered by MFIs on SMEs' performance in Nakuru town?

1.5   Significance of Study

This study will be of benefit to the SMEs because they will be able to use the results of this study to overcome the challenges that might be preventing them from accessing finances with ease from MFIs. They will also be able to understand the views that the MFIs have towards the financing done to SMEs.

A study of this nature is equally very important because it is going to enlighten the government and the public on the role MFIs are playing in the SMEs sector. The results of this study may be used by the government of Kenya to find ways of helping the SMEs in order to realize profit from their enterprises. The government can use the result of this study to come up with policies that ensure that the SMEs and MFIs have good working environment since this study will be able to make explicit the challenges that the MFIs and SMEs are facing. The government because of the findings of this study may find ways in

which they can provide security and collaterals for the loans that the SMEs take from the MFIs.

The NGOs may find the findings of this study of immense importance in finding ways of helping the SMEs in Kenya. This study can provide a basis of sourcing funding from donors that will help in the financing of business operations of the SMEs in the country.

This study will also be of immense significance to the scholars because it will add to the existing pool of knowledge on the impacts that MFIs have on the performance of SMEs. This study will form part of the references from which researchers can get information about the effects of MFIs services on the performance of SMEs within Nakuru town.

1.6   Scope of the Study

This study was based on the effects of MFIs services on the performance of SMEs within Nakuru town. This study tried to access the effect of microfinance services on Small and Medium Enterprises in Nakuru town. The target population was the SMEs operating SME's shops. Questionnaires and interviews were used as tools for data collection.

1.7   Delimitation of the Study

The study focused only on the SMEs that are funded by MFIs within Nakuru town. The study recruited those SMEs operating SME's shops. During the course of the research the study did not focus much on the operations of MFIs but a big attention was on the performance of SMEs.

1.8   Operational Definition Terms

Firm -This refer to a single decision making production unit which produces goods and services consumed but governments, consumers, producers and foreigners (Hailey and Balogun,2004). In this study the term firm has been used to mean companies offering data services.

Microfinance: -this is the provision of financial services to low-income clients or solidarity lending groups including consumers and the self-employed, who traditionally lack access to banking and related services (Rosengard, 2000).

MFI services – this is the provision ofa wide range of financial services (loans, savings, micro insurance, leasing, mortgaging and money transfer) and Non-financial services (advisory, references, training, counseling, social corporate responsibility, business culture and ethics, business customer care and business location), which services and products affect the growth of SMEs, (Mosley, 2008).

Performance - performance is the measure of standard or prescribed indicators of effectiveness and efficiency. Performance refers to the metrics relating to how a particular request is handled, or the act of performing; of doing something successfully; using knowledge as distinguished from merely possessing it. (Venkatraman&Ramanujam, 2001).

Small and Medium Enterprise*: -* is an enterprise which employs fewer than 10 persons and whose annual turnover and/or annual balance sheet total does not exceed Ksh 200 million.(Little, 2007).

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter presents the review of literature from other researchers who have carried out similar researches in the same field of study. The focus of the study will be conducted in Nakuru Town and provides an in-depth presentation on the effects of MFIs services on the performance of SMEs within Nakuru town. The specific areas covered here are the theoretical review, empirical review and conceptual framework.

2.2 Theoretical Review

2.2.1 Resource-Based View (RBV) Theory

This theory was postulated by Zeller, (2003) and states that firms possess resources, a subset of which enables them to achieve competitive advantage, and a subset of those that lead to superior long-term performance. Resources that are valuable and rare can lead to the creation of competitive advantage. That advantage can be sustained over longer time periods to the extent that the firm is able to protect against resource imitation, transfer, or substitution. In general, empirical studies using the theory have strongly supported the resource-based view.The resource-based view (RBV) is a business management tool used to determine the strategic resources available to a company. The fundamental principle of the RBV is that the basis for a competitive advantage of a firm lies primarily in the application of the bundle of valuable resources at the firm's disposal To transform a short-run competitive advantage into a sustained competitive advantage requires that these resources are heterogeneous in nature and not perfectly mobile. Effectively, this translates into valuable resources that are neither perfectly imitable nor substitutable without great effort. If these conditions hold, the firm's bundle of resources can assist the firm sustaining above average returns, (Snodgrass, 2006).

Entrepreneurs have individual-specific resources that facilitate the recognition of new opportunities and the assembling of resources for the venture. By focusing on resources, from opportunity recognition to the ability to organize these resources into a firm and then to the creation of heterogeneous outputs through the firm that are superior to the market, we help identify issues that begin to address the distinctive domain of entrepreneurship (Snodgrass, 2006).

2.2.2 The Hybrid Theory

This theory demonstrates that the demand for inner-city life is extremely high, and that any effort made to balance out the number of labour jobs and intellectual jobs would only result in a mass negative response. The greatest problem that these types of people initially face is the lack of money to finance their pursuits. Especially under the new conditions of today's economy, banks are facing even tougher decisions on when to loan, who to loan money too, and how much to loan. With such little trust between lenders and borrowers, it seems that the only solution for large banking corporations is to make sure-fire deals with borrowers, guaranteeing their repayment at whatever cost. Through the use of this method, a large majority of borrowers are merely refused because of their income and reliability as borrowers (Weldern, 2002).

2.2.3 Criticism of the Theories

According to Weldern, (2002), resources are the inputs or the factors available to a company which helps to perform its operations or carry out its activities. Also, (Snodgrass, 2006) state that resources, if considered as isolated factors do not result in productivity; hence, coordination of resources is important. The ways a firm can create a barrier to imitation are known as "isolating mechanisms", and are reflected in the aspects of corporate culture,

managerial capabilities, information asymmetries and property rights. Further, they mention that except for legislative restrictions created through property rights, the other three aspects are direct or indirect results of managerial practices.

Weldern (2002), mentions inter-firm causal ambiguity may results in sustainable competitive advantage for some firms. Causal ambiguity is the continuum that describes the degree to which decision makers understand the relationship between organizational inputs and outputs (Snodgrass, 2006). Their argument is that inability of competitors to understand what causes the superior performance of another (inter-firm causal ambiguity), helps to reach a sustainable competitive advantage for the one who is presently performing at a superior level. Weldern, (2002) also states that social context of certain resource conditions act as an element to create isolating mechanisms and quote (Weldern, 2002) that tacitness (accumulated skill-based resources acquired through learning by doing) complexity (large number of inter-related resources being used) and specificity (dedication of certain resources to specific activities) and ultimately, these three characteristics will result in a competitive barrier.

While explanations of entrepreneurship have adopted different theoretical assumptions, most of these concern three central features of entrepreneurial phenomena: the nature of entrepreneurial opportunities, the nature of entrepreneurs as individuals, and the nature of the decision making context within which entrepreneurs operate. Nonetheless, various theoretical traditions in the field have adopted radically different interpretations with respect to these assumptions of entrepreneurial phenomena, therefore arriving at different explanations of these phenomena, (Snodgrass, 2006).

A number of studies have been conducted on microfinance services. Copstake, et.al (2000) did a study on the impact of microcredit on poverty in Zambia. The programme was not directed towards the poorest business operators but one third of the clients who were below national poverty line. Those who graduated from their first to a second loan on average experienced significant higher growth in their profit and household income, as compared with otherwise similar business operators. The borrowers also diversified their business activities more rapidly. However some borrowers were worse off especially among the 50% or so who left the programme after receiving only one loan.

Alarape (2007) did a study to examine the impact of owners/managers of small business participating in entrepreneurship programs on operational efficiency and growth of small enterprises in Nigeria. The study was a cross-sectional analysis of impact of exposure of owners managers of small businesses on their performance of operational efficiency and growth rate. The data was collected from primary and secondary sources. Both descriptive and inferential statistics were employed for the analysis. The findings were that small business whose owners, managers had experience of participating in entrepreneurship programs exhibited superior managerial practice, had higher gross margin rate of growth than small businesses whose owner managers did not have superior experimental learning. This had a practical implication that there is need to improve managerial practice of small businesses through exposure of owners/managers to entrepreneurship programs in order to enhance their performance and transition to medium and large business.

Nilsson (2010) conducted a study to investigate the impact of micro finance institutions (MFIs) on the development of small and medium size businesses (SMEs) in Cameroon. The study adopted a case study approach that involved CAMCCUL – (Cameroon Cooperative

Credit Union League). The study concluded that microfinance is an important asset to developing countries since it is able to cater for financing needs of the very poor in the society.

Bran and Woller (2010) carried out a study to establish the effects of microfinance in India. The study concluded that microfinance has brought better psychological and social empowerment than economic empowerment. The study further recommended that the impact of microfinance is commendable in courage, self-confident, self-worthiness, skill development, awareness about environment, peace in the family, reduction of poverty improving rural savings, managerial ability decision making process and group management. In other variables the impact is moderate. As a result of participation in microfinance, there is observed a significant improvement of managerial skills, psychological well-being and social empowerment. It is recommended that the SHGs may be granted legal status to enhance the performance.

Olu (2009) 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 .Table 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 affectedindividuals, 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. Memba et. al, (2012) conducted a study to establish the impact of venture capital on growth of SMEs in Kenya.

The study used 200 SMEs that have been financed by Venture capital as the target population. The SMEs were drawn from various major urban centers in Kenya. The SMEs were stratified according to their locality and a random sampling was carried out by assigning numbers to each stratum. A sample of 100 firms was picked at random from which data was collected using a semi-structured questionnaire as the main tool for data collection. Data was analyzed using descriptive statistics with the help of SPSS computer software. The variables used to measure growth were sales per annum, net assets, profit per annum, and number of workers among others.

They were analyzed before and after use of venture capital. The study established that SMEs made significant growth after accessing the financing and recommended that other SMEs should follow suit if the country has to achieve its vision 2030. It was argued that lack of finance has been stated as one of the main reasons for SMEs poor performance in most developing countries.

Cooper (2012) conducted a study on the impact of micro-finance services on the growth of SMEs in Kenya. The study targeted 50 SMEs in Nairobi. The researcher used self - developed questionnaire as an instrument of data collection and analyzed the data using quantitative analysis. The study established that SMEs largely depend on micro financing for growth. A significant percentage of SMEs was found to have access and do seek micro credit for their businesses. The study also established that microfinance services have assisted enterprises to change their status through growth in sales level from micro to small and from small to medium. Though SMEs have easy access to micro finance services, the study indicated that they have no exemption from strict requirements when applying for loans. The study also established that most SMEs in Nairobi do not demand for micro-insurance services and that Microfinance Institutions offer minimal training to SMEs. The study concluded that microfinance services have a strong positive impact on the growth of SMEs in Kenya. SMES in Nairobi depend on micro financing for growth.

The study recommends that there is need to relax the requirements for loan application and that the government of Kenya should provide a favourable environment that can allow MFIs to thrive not only in Nairobi but also in other parts of the country Koech (2011) conducted a study to find out the financial constraints that hinder growth of SMEs in Kenya. The researcher adapted the case study approach and targeted SMEs in Kamukunji District. The

study used structured questionnaires as the main tool for data collection. Data was analyzed by exploratory factor analysis and descriptive analysis with the help of SPSS to obtain percentages and frequency distribution tables. The factors hindering growth of SMEs were identified as capital access, cost, capital market collateral requirements information access, capital management and cost of registration. The study recommended that business financiers through loans consider reducing collateral requirements to facilitate SMEs easy access to loans.

2.3   Concept of Microfinance

The review of literature on the growth MSEs indicated that many micro and small enterprises (MSEs) fail to expand due to limited financial resources ,poor managements ,use of outdated technologies ,stiff competitions from bigger firms, poor management of account receivables ,unfavorable government policies among .According to Yaron (1997) the study found that poor access to loans and limited finance as the main causes limiting the growth of micro and small enterprises .

A study by Grameen Bank (1983) found that many MSEs had limited capital, lacked relevant skills and used outdated technologies that constrained their growth. However, there are a number of factors that influence the decisions of MSEs' operators and mangers before deciding the source and amount of finance to finance business investments to invest in business activities. Prasad, Green and Murinde (2005) found that financing policy, capital structure and firm ownership are all strongly linked. Their argument was that financing policy by firms requires managers to identify ways of funding new investment. The managers may exercise main choices: use retained earnings, borrow or issue new shares.

Robinson (2003) postulated that Microfinance is a development tool that provides or grants financial servicesand products such as very small loans, savings, micro-leasing, micro-insurance and money transfer to assist the very or exceptionally poor in expanding or establishing their businesses"" Microfinance enables the poor and excluded section of people in the society who do not have an access to formal banking to build assets, diversity livelihood options and increase income, and reduce their vulnerability to economic stress. Microfinance arose in the 1980s as a response to doubts and research findings about state delivery of subsidised credit to poor farmers.

Institutions which include mainly Non-Governmental Organisations played a major role in the development of Microfinance by developing a successful credit and training system for individual micro entrepreneurs, establishing solidarity group lending to urban vendors and in Asia where Dr Mohamed Yunus of Bangladesh initiated a pilot group lending scheme for landless people.(Ledgerwood,1999:). Microfinance in general can be Non-Governmental Organisations (NGOs), Savings and Loans Cooperative, Government banks, Commercial banks or Non-Bank Financial Institutions (Ledgerwood, 1999).Microfinance clients are typically self-employed, low income entrepreneurs in both rural and urban areas, traders small farmers, service providers (Ledgerwood, 1999). In theKenya an set up Microfinance Institutions are privately owned , owned by Commercial banks , Government Owned vehicles (SEDCO), Donor funded Savings and Loans Cooperatives and organisations among others.

2.3.1 Microfinance and Small to Medium Enterprises

Ahiabor, 2013 examined the impact of Microfinance on Small and Medium Enterprises (SMEs) in Ghana, using a case study of the Ledzorkuku-Krowor Municipal Assembly. The findings of the study revealed that to a greater extent SMEs had the knowledge of the

17

existence of MFIs and acknowledged positive contributions of MFIs loans towards promoting their growth. He further suggested that, other than financial support, it is recommended that microfinance institutions should at all-time give professional advices to SMEs since proper professional advice serve to inform the lending microfinance institutions whether the amount the SME requested for is too much for the project or less. In line with that Idowu 2009 assessed the impact of Microfinance on Small and Medium Enterprises (SMEs) in Nigeria and asserted that quite a significant number of the SMEs managed to access MFIs loans even though only few of them were capable enough to secure the amounts they actually required. Idowu further pointed out that majority of the SMEs acknowledged positive contributions of MFIs loans towards promoting their market share, product innovation and the SMEs overall competitive advantage.

Ngwenya and Ndlovu, 2003 carried out a research study to evaluate the performance of MFIs in relation to the promotion of Credit access to the Poor in Kenya. They highlighted that despite facing some industry wide challenges, MFIs made a significant impact in linking SMEs and the poor to sources of credit. They recommended the Kenya government to formulate a strategic plan on SMEs and MFIs for prudential operations. They also recommended that the government of Kenya must make information disclosure by MFIs mandatory and also encouraged MFIs to introduce insurance products to cushion both themselves (MFIs) and SMEs in the event of a problem.

Ali et al, 2013 investigated the accessibility of microfinance for small businesses in Mogadishu. The main objective of the research study was to examine the challenges which were being faced by small businesses in accessing microfinance services in Mogadishu. The main findings were that Small businesses in Mogadishu were facing challenges to access

loans from MFIs and this results many small business to close shop some may not have started due to lack of ability to overcome the challenges. The researchers recommended that microfinance institution were required to set more flexible, affordable and attractive requirements in financing Small businesses, their role need to be felt by the Small enterprises in terms of growth and development. Odebiyi and Olaoye, 2012 carried out a research study on the role of Microfinance in the development of Small and Medium Scale Aquaculture enterprises in Nigeria. The results of the study indicated a positive impact of microfinance bank loan on small and medium scale aquaculture development as it increased the revenue of the farmers, reduced rural-urban migration and increased overall yield and even generate employment opportunities. Ojo, 2009 examined the impact of microfinance on entrepreneurial development of small scale enterprises in Nigeria.

Three different hypotheses were formulated and tested using various statistical tools such as chi-square test, analysis of variance and simple regression analysis. The study revealed that there was a significant difference in the number of entrepreneurs who used microfinance institutions and those who do not use them; there was a significant effect of microfinance institutions activities in predicting entrepreneurial productivity; and that there was no significant effect of microfinance institutions activities in predicting entrepreneurial development. The researcher found out that microfinance institutions world over and especially in Nigeria was identified to be one of the key players in the financial industry that had 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.

Oni E et al 2012, assessed the contributions of MFIs to the sustainable growth of SMEs in Nigeria. The analysis revealed that MFIs did and contributed to the sustainable growth of SMEs in the Nigeria. Their research study however also found out that MFIs services outreach to SMEs was poor. The researchers recommended appropriate modification to be made to address gaps for MFIs to effectively contribute to SMEs activities in the country. They also highlighted that apart from creating greater SMEs out-reach to MFIs services through establishment of rural branches, both government and MFIs can increase SMEs access to MFIs services through intensified campaigns at the local government and ward levels.

Vogelgesangu, 2001 analysed the impact of microfinance loans on productivity and growth of client"s enterprises. The researcher used client database of Caja Los Andes, one leading micro finance in Bolivia. The results highlighted that the clients put the MFI loans to good use and clients with a higher number and a higher average size of MFI loans were found to have higher growth rates than other clients. A crossectional analysis of sales revenue showed that clients with MFI loans generated higher sales revenue than others for a given asset level. Coleman 1999 examined if loans accessed from MFIs were effectively utilized by borrowers and suggested that the village bank credit did not have any significant and physical asset accumulation to the borrowers. The women ended up in a vicious cycle of debt as they used the money from the village banks for consumption purposes and they were also forced to borrow from money lenders at high interest rate to repay the village bank loans so as to qualify for more loans. The study mainly highlighted that credit was not an effective tool to help the poor out of poverty or enhance their economic condition.

The researcher further suggested that the poor are too poor because of some other hindering factors such as lack of access to markets, price stocks, unequal land distribution but not lack of access to credit. Montgomery et al, 1996 suggested that though women accessed loans from MFIs as this is viewed by most microfinance service providers as enhancing women empowerment drive and eradication of poverty from the women the majority of women did not have control over loans taken by them when married. In Line with that,Goetz and Gupta, 1994 asserted that in most Microfinance programs women were the main target of the credit program but the management and utilisation of the loans was made by the men hence not making the development objective of lending to the women to be met.

2.3.2   Cost of Credit

The studies and empirical evidences on finance consistently address that inadequacies in access to finance are key obstacle to SMEs growth. Thomas, (2010) shows that SME find financing more difficult than larger firms, (Weldern, 2002).

The institutional framework within which firms, in this case SMEs, interact with MFIs, government, NGOs and other service providers, and each other, can have a profound influence on a SMEs economic and noneconomic performance. Mnenwa and Maliti (2009) report that education, motivation, sources of initial capital and technology are some of the socio-economic factors that have a positive influence on profit margins and employment creation. The potential and ability of small businesses to contribute to poverty reduction objectives are largely vested in the capacity of the SME institutions to provide the needed education, incentives, employment and capital.

Babajide (2007) argued that MFIs can offer their clients who are mostly the men and women who could be below or slightly above the poverty line a variety of products and services. The most prominent of their services is financial. This they often render to their clients without tangible assets as collateral security. These clients mostly live in the rural areas and a majority of whom are illiterate. Formal financial institutions do not often provide these services to small informal businesses run by the poor as profitable investments. They usually ask for small loans and the financial institutions find it difficult to get information from them either because they are illiterates and cannot express themselves or because of the difficulties to access their collateral (farms) due to distance. It is by this that the cost to lend a dollar will be very high and also there is no tangible security for the loan. The high lending cost is explained by the transaction cost theory. The transaction cost can be conceptualized as a non-financial cost incurred in credit delivery by the borrower and the lender before, during and after the disbursement of loan. The cost incurred by the lender include; cost of searching for funds to loan, cost of designing credit contracts, cost of screening borrowers, assessing project feasibility, cost of scrutinizing loan application, cost of providing credit training to staff and borrowers, and the cost of monitoring and putting into effect loan contracts.

On the other hand, the borrowers may incur cost ranging from cost associated in screening group member (group borrowing), cost of forming a group, cost of negotiating with the lender, cost of filling paper work, transportation to and from the financial institution, cost of time spent on project appraisal and cost of attending meetings (Christabell, 2009). The parties involved have the sole responsibility to reduce the risk they may come across. Microfinance comprise of financial sustainability, outreach to the poor, and institutional impact in a triangular manner. There are costs to be incurred when reaching out to the poor and most especially with small loans. The financial institutions always try to keep this cost as

22

minimum as possible and when the poor are in a dispersed and vast geographical area, the cost of outreach increases. The provision of financial services to the poor is expensive and as argued by Adam and Pischke (1992) making financial institutions sustainable requires patience and attention to avoid excessive cost and risks.

The deliveries of MFIs products and services have transaction cost consequences in order to have greater outreach. Some microfinance institutions visit their clients instead of them to come to the institution thereby reducing the cost that clients may suffer from For MFIs to be sustainable, it is important for them to have break-even interest rates. This interest rates need to be much higher so that the financial institution's revenue can cover the total expenditure (Hulme and Mosley, 1996). Moreover, the break-even rate which is higher than the market rate is defined as the difference between the cost of supply and the cost of demand of the products and services. The loan interest rates are often subsidized (Robinson, 2003). He further notes that loans demanded by smaller enterprises are smaller than those requested by larger ones but the interest rates remain the same. This indicates that, per unit cost is high for MFIs targeting customers with very small loans and possessing small savings accounts. Even though the interest rate is high for applicants requesting very small loans, they are able to repay and even seek repeatedly for new loans. The social benefits that are gained by clients of MFIs supersede the high interest charged (Rosenberg, 1996). The high interest rate is also as a means to tackle the problem of adverse selection where a choice is made between risky and non-risky projects. This implies that the good clients suffer at the expense of the bad ones as noted by Babajide (2007).

Low-income men and women have a serious hindrance in gaining access to finance from formal financial institutions. Ordinary financial intermediation is not more often than not

enough to help them participate, and therefore MFIs have to adopt tools to bridge the gaps created by poverty, gender, illiteracy and remoteness. The clients also need to be trained so as to have the skills for specific production and business management as well as better access to markets so as to make profitable use of the financial resource they receive (Bennett, 1994). In providing effective financial services to the poor requires social intermediation. The author argues that it is "the process of creating social capital as a support to sustainable financial intermediation with poor and disadvantaged groups or individuals". 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. This implies that the services provided to microfinance clients can be categorized into four major different categories: Financial intermediation, Social intermediation, Enterprise development services and Social services.

Accessing credit is considered to be an important factor in increasing the growth of Small and Medium Enterprises. It is thought that credit augment income levels, increases employment and thereby alleviate poverty. It is believed that access to credit enables poor people to overcome their liquidity constraints and undertake some investments such as the improvement of farm technology inputs thereby leading to an increase in agricultural production (Hiedhues, 1995). The main objective of microcredit according to Navajas et al, (2000) is to improve the welfare of the poor as a result of better access to small loans that are not offered by the formal financial institutions.

Diagne and Zeller (2001) argue 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 credit further increases SME.s risk-bearing abilities; improve risk-copying strategies and enables consumption smoothing overtime. With these arguments, microfinance is assumed to improve the welfare of the poor. It is argued that MFIs that are financially sustainable with high outreach have a greater livelihood and also have a positive impact on SME development because they guarantee sustainable access to credit by the poor (Rhyne and Otero, 1992).

Buckley (1997) argues that, the indicators of success of microcredit programs namely high repayment rate, outreach and financial sustainability do not take into consideration what impact it has on micro enterprise operations and only focusing on "microfinance evangelism". Carrying out research in three countries; Kenya, Malawi and Ghana, he came to the conclusion that there was little evidence to suggest that any significant and sustained impact of microfinance services on clients in terms of SME development, increased income flows or level of employment. The focus in this augment is that improvement to access to microfinance and market for the poor people was not sufficient unless the change or improvement is accompanied by changes in technology and or technique.

Zeller and Sharma (1998) argue that microfinance can aid in the improvement or establishment of family enterprise, potentially making the difference between alleviating poverty and economically secure life. On the other hand, Berger (1989) indicates that microfinance tends to stabilize rather than increase income and tends to preserve rather than to create jobs.

Findings by Coleman (1999) suggest that the village bank credit did not have any significant and physical asset accumulation. The women ended up in a vicious cycle of debt as they use the money from the village banks for consumption purposes and were forced to borrow from money lenders at high interest rate to repay the village bank loans so as to qualify for more loans. Themain observation from this study was that credit was not an effective tool to help the poor out of poverty or enhance their economic condition. It also concluded that the poor are too poor because of some other hindering factors such as lack of access to markets, price stocks, unequal land distribution but not lack of access to credit.

The study by Mosley and Hulme (1998) concludes that household income tends to increase at a decreasing rate as the income and asset position of the debtors is improved. Similar views are held by Diagne and Zeller (2001) who suggest that microfinance do not have any significant effect in household income meaning no effect on SME development. Investing in SME activities will have no effect in raising household income unless the infrastructure and market is developed. Some studies have also argued that using gender empowerment as an impact indicator of microcredit has a negative impact (Goetz and Gupta, 1994; Montgomery et al, 1996). Using a "managerial control" index as an indicator of women empowerment, it came to conclusion that the majority of women did not have control over loans taken by them when married yet it was the women who were the main target of the credit program. The management of the loans was made by the men hence not making the development objective of lending to the women to be met.

Africa's SMEs have little access to finance, which thus hampers their emergence and eventual growth. Their main sources of capital are their retained earnings and informal savings and loan associations (tontines), which are unpredictable, not very secure and have

little scope for risk sharing because of their regional or sectorial focus. Access to formal finance is poor because of the high risk of default among SMEs and due to inadequate financial facilities. Small business in Africa can rarely meet the conditions set by financial institutions, which see SMEs as a risk because of poor guarantees and lack of information about their ability to repay loans. The financial system in most of Africa is under-developed however and so provides few financial instruments. Capital markets are in their infancy, shareholding is rare and no long-term financing is available for SMEs. Non-bank financial intermediaries, such as microcredit institutions, could be a big help in lending money smallest SMEs but they do not have the resources to follow up their customers when they expand. Improving business conditions, boosting the capacity of SMEs, expanding the financial sector and strengthening links between firms will permanently increase SMEs' access to finance (Weldern, 2002).

2.3.2.1 Challenges to Capital Access by SMEs

Africa's SMEs have little access to finance, which thus hampers their emergence and eventual growth. Their main sources of capital are their retained earnings and informal savings and loan associations, which are unpredictable, not very secure and have little scope for risk sharing because of their regional or sectorial focus. Access to formal finance is poor because of the high risk of default among SMEs and due to inadequate financial facilities.Small business in Africa can rarely meet the conditions set by financial institutions, which see SMEs as a risk because of poor guarantees and lack of information about their ability to repay loans. The financial system in most of Africa is under-developed however and so provides few financial instruments.

Capital markets are in their infancy, shareholding is rare and no long-term financing is available for SMEs. Non-bank financial intermediaries, such as micro-credit institutions, could be a big help in lending money to the smallest SMEs but they do not have the resources to follow up their customers when they expand. (Okraku, 2007). The access to finance has been hard because of high interest rate and disparities between savings account returns and borrowing rates. Most MFIs also require the collateral requirement such as land ownership so as to lend out funds. Loan security is one of the important aspects of credit to SMEs. He reported that most lending to small-scale enterprises is security based, without any regard for potential cash flow. However, organizations lending to micro-enterprises have devised alternative forms of collateral. These include: group credit guarantees, where organizations lend to individuals using groups as guarantors, and personal guarantors, where individuals are given loans based on a guarantor's pledge.

Lack of access to credit is almost universally indicated as a key problem for SMEs. This affects technology choice by limiting the number of alternatives that can be considered. Many SMEs may use an inappropriate technology because it is the only one they can afford. In some cases, even where credit is available, the entrepreneur may lack freedom of choice because the lending conditions may force the purchase of heavy, immovable equipment that can serve as collateral for the loan.

Credit constraints operate in variety of ways in Kenya where undeveloped capital market forces entrepreneurs to rely on self-financing or borrowing from friends or relatives. Lack of access to long-term credit for small enterprises forces them to rely on high cost short term finance.

There are various other financial challenges that face small enterprises. They include the high cost of credit, high bank charges and fees. The scenario witnessed in Kenya particularly during the climaxing period of the year 2008 testifies the need for credit among the common and low earning entrepreneurs. Numerous money lenders in the name of Pyramid schemes came up, promising hope among the 'little investors,' which they can make it to the financial freedom through soft borrowing. The rationale behind turning to these schemes among a good number of entrepreneurs is mainly to seek alternatives and soft credit with low interest rates while making profits. Financial constraint remains a major challenge facing SMEs in Kenya. (Nchari, 2003).

2.3.2.2   Reasons for collapse of SMEs

The causes of SMEs collapse are many and varied and may stem both from the external environment and from factors internal to the business. Internal causes of business failure may in many cases be capable of being foreseen in advance, while on the other hand some external causes are not so predictable. In most cases, a complex mixture of causes contributes to business failure; it is very rare for one single factor to be involved, (Little, 2007).With respect to SMEs, the following internal and external threats to their survival and growth have been identified.

2.3.2.3   Internal Causes of Business Failure

By definition, problems that are 'internal' to a business are more likely to be predictable than matters which are external to the business and over which the latter may have no control. Accordingly, 'internal' threats to the viability of a business are more capable of being anticipated and planned for than threats from outside, (Little, 2007).

The most commonly occurring 'internal' factor in business failure among SMEs is poor management. Even other internal causes of business failure are often inevitably linked to poor management. This term is used here in a broad sense to refer to the failure of the management of an SME to be able to ensure that problems are identified promptly and the correct solutions applied, so as to give the company the best possible chance of survival and growth,(Little, 2007).

Management competence is clearly an issue for businesses of all sizes, since it is management which is invariably responsible for making all the important commercial decisions in the company. However, the smaller the business, the less likely it is that a company will have, in-house, the specialist financial skills and experience which are vital for ensuring that the decisions made are ones which will best serve the company's financial interests.

Most small businesses are established by one entrepreneur, or a small group of them, who have what they believe, are a good idea for creating a specific product or providing a particular service. They will usually have skills and experience in the area of activity for which the new business is formed, (Little, 2007).

But however good their products and services may be, many SME entrepreneurs do not always have skills and experience in areas such as business planning financial reporting, marketing, customer relations and financial management. Managing a successful SME requires not only good creative and operational skills but good business skills too. Many SMEs do not appreciate until it is too late that, if they do not have these skills in-house, then the success of their business may well depend on them importing those skills from specialist

advisors from outside the company or quickly developing basic business skills themselves, (Little, 2007).

Start-ups businesses are inherently more risky than more established businesses. The first three years of the life of a new business are usually particularly difficult, and a high proportion of new businesses fail during that period. The risk stems from the fact that the business has to prove itself quickly - to customers and suppliers, providers of finance, employees and possibly outside investors too.

Business decisions need to be supported by good quality financial information, which needs to be relevant, user-friendly and available in a timely manner. Poor accounting and reporting and decisions based upon inaccurate or incorrect financial information can actually cause problems which may threaten the solvency of the business, (Little, 2007).

Where a business operates poor bookkeeping practices which do not comply with recognised accounting principles, it risks incurring penalties from the regulatory authorities. This can apply in many areas, going from general ledger, receivables and payables, to indirect and direct tax (VAT books, VAT returns, other indirect taxes, and income return). In some Member States poor accounting can cause an inspection from fiscal authorities, which can last for a few months and cause considerable burdens on the business, slowing down routine activities.

In addition, poor accounting increases the risk of the business of not being aware of significant problems or of it recognizing them too late. Elements such as excessive fixed and

variable costs, incorrect revenue recognition, decrease in sales, etc., if not promptly recognized, can lead in the long run to damage to the solvency of the business.

Poor quality or misleading accounting information can result essentially from two factors: either it depends on mistakes of the management or can be driven by tax considerations. In the long-term inappropriate accounting treatment not in accordance with recognized accounting principles (in areas such as depreciation, bad debt, stock, etc.) can lead to a decline in business performance, (Little, 2007).

Little (2007), highlighted that poor accounting practices will also, unless corrected, be reflected in the company's statutory financial statements. If the accounting is not in accordance with recognised accounting principles, the financial statements will not give a 'true and fair' view of the financial position of the company, and of the results of its operations and its cash flow'.

Poor cash flow management, amongst the most common internal causes of business failure, implies an imbalance between the payment terms taken by debtors and those given to creditors.The most obvious outcome of defective cash flow management is a significant decline in cash, with the business being unable to cover its repayment obligations, either to banks for loans, or towards suppliers for purchased goods and services. Inadequate management of inventory and Work In Progress (WIP) can also lead to cash flow problems. The ultimate result of poor cash flow management is lack of working capital to run day-to-day activities. (Nchari, 2003).

An unbalanced mix of risk capital and loan capital represents a threat to the solvency of the business. An extreme reliance on loan finance can test the company's cash flow position, leading to excessive obligations for the company to repay capital and associated interest, especially when loan conditions allow the lender to vary interest rates (Nchari, 2003).

If the company starts to experience financial difficulties, insufficient risk capital will only worsen the situation, as the existing loan capital may prevent raising further debt finance. In addition, unsuitable financing options result in an inconsistency between the liquidity of assets and the sources of financing, i.e. financing short-term assets with long-term loans, instead of short-term debt, or borrowing short to invest long, (Little, 2007).

Little(2007), is quoted as stating that excessive reliance on only one customer, or alternatively only one supplier, poses very high risks to a business. In the event of the only customer's insolvency or withdrawal of orders, the gross margin will drop significantly owing to the sudden reduction in sales. The whole future of the business is put at risk, as there may be no market for its products or services.

The same applies in case of reliance on only one supplier, as in the event of a sudden supply failure or break of the commercial relationship, the business will be in danger: because of its entire dependency on the supplier, it will have no alternative sources of supply, (Little, 2007). Impeding bad debt is one of the possible causes of business failure that is capable of being predicted in advance. Bad debts may increase significantly, due to the insolvency or disappearance of a customer.

This often leads in the long run to insolvency. The main problem for SMEs, though, may be in actually identifying potential bad debts and being able to reduce them. In many SMEs, there will not be an in-house credit collection department which is able to undertake regular credit control activity and follow up matters of going-concern. For this reason, bad debts may have a more dramatic impact on SMEs than on larger businesses, (Little, 2007).

Amongst start-up businesses a frequent cause of businesses failure is a lack of adequate and appropriate market research. Market research is required to help businesses to identify their customers and inform them of the size of the potential customer base, to determine what price customers might be prepared to pay and to suggest how demand for the product or service will change according to the price charged. Research will also inform them about their competitors and their likely reaction to a new entrant to the marketplace, (Little, 2007).

In a new business this information is vital to enable the company to calculate whether it will make sufficient gross margins to cover its overheads and financing costs and make an adequate profit. More established businesses will have addressed some of these issues. However they need to be constantly aware of how their marketplace is changing, what their competitors are doing and planning, who can be the potential new entrants to the marketplace and how they will affect their trade, (Little, 2007).

Fraud and collusion, where not detected in good time, can also cause significant financial loss and reduction of business performance. The most typical case of fraud is the one committed by employees, namely by falsifying expense reports or by stealing small unit-value items, such as stationery or cleaning products. When such thefts happen regularly, and are left uncontrolled, they can lead to significant losses. Collusion with the stakeholders of the

business can also have serious consequences. The employee may make a secret agreement with a supplier whereby the delivery is lower than that indicated by the invoice, and the employee is paid remuneration for the so-called 'favor' (Nchari, 2003).

Similar secret agreements can be made by an employee and a customer, arranging that the latter receive more goods or services than that indicated by the invoice, in return for compensation to the fraudulent employee. Other secret deals can be made by the employee responsible for treasury with the banks operating with the business, (Little, 2007).Additionally fraud can be also perpetrated by the entrepreneur or their spouse, or by a trusted advisor

2.3.2.4   External Causes of Business Failure

External factors which in the long run may cause SMEs to fail cannot always easily be predicted, since they may involve extraordinary or unusual events happening in the region or country where the company operates, events over which the business has no influence (Nchari, 2003).

Mosley(2008), was of the idea that recession in the economy, either at EU level or at national level, represents one unpredictable event, as well as a sudden decline in the specific field of activity of the business may also cause insolvency of the business. Other possible issues generally related to market economy, which might threaten business failure are change of buying patterns: likely to be influenced by socio-political developments (i.e. increasing importance of environmental compatibility of industrial products); and decreasing purchasing power of consumers or groups of consumers: could produce as a consequence decreasing wages or unemployment. Customers' strikes may also provoke significant damages at the

level of the supplying enterprises. Substitution products also often lead to changes in the market and in the preferences of consumers.

Mosley(2008), also proposed that natural disasters such as fire, floods, earthquakes and terrorism cannot normally be foreseen in advance. The only possible way to cover such risks is to prudently insure against them, especially if the region in which the business operates is frequently subject to environmental disasters. Even in this case, a delay in obtaining the indemnity from the insurance company may damage the business's cash flow.

Strict governmental measures may affect specific sectors of business activity and impose stringent burden on SMEs. International developments, like war treaties or trade agreements, may have similar effects. Such developments cannot always be predicted, although the entrepreneur can keep himself always up to date following the financial press, (Mosley, 2008).

Measures to protect the environment and other similar social protection measures can have financial implications for businesses, both in terms of cost of compliance and of financial penalties which may be imposed by the authorities in case of non-compliance, (Mosley, 2008).

It has already been mentioned that a business which is overly dependent on one sole customer or supplier is likely to be at higher risk than a business that has a variety of customers and suppliers to trade with. Whenever the customers or suppliers concerned are experiencing financial problems, they will pass on their problems to the business. For instance, if the sole

customer is no longer able to pay its bills on time, the seller will be short of cash, and will start having problems in paying back its own suppliers, (Mosley, 2008).

Similarly, in the case of manufacturing companies, where the sole supplier goes bankrupt, no more goods will be received, causing a stop in the production process; the same will apply in the case of services or retail companies, which will no longer be able to meet their sales and delivery commitments whenever the sole supplier experiences failure. The bankruptcy of a sole supplier will obviously threaten the on-going relationships of the business with its customers, (Mosley, 2008).

Carpenter and Petersen (2002) argue that firms whose financial needs exceed their internal resources may be constrained to pursue potential opportunities for growth. The insufficient internally generated liquidity is therefore one of the factors which are frequently cited as the causes of micro and small business failure in developing economies. It is from this perspective,the micro credits are considered to be an appropriate solution because the amount of money needed to start a micro or small business is generally quite minimal (Sonfield & Barbato, 1999). Access to credit enables the MSEs owner to cover some or all of the cost of capital equipment, expansion, or renovation of buildings. Similarly, UWFT (2005) found that majority of MSEs that accessed adequate funds from microfinance institutions increased their volume of sales and the profit. The study also found MSEs acquired assets using MFIs loans. According to a study by UNDP (2002) found that MSEs in Kenya were able to acquire fixed assets and technologies using MFIs. The study established a positive significant relationship between amount of loan and MSEs achievement of goals. Makokha (2006) revealed that inadequacy of capital hindered the expansion of businesses. The study further found that larger loans enabled MSEs to graduate to medium enterprises. This argument is supported by

Otto, Muli and Ong'ayo (2010) in their study that indicated that those MSEs that received large loans frequently had larger labour force than those MSEs that received smaller loans. Appropriate loan sizes for clients matching their needs, realistic interest rates, savings as a prerequisite, regular, short and immediate repayment periods and achieving scale can contribute to the sustainability of micro and small enterprises.

2.4   Training

Entrepreneurs who start a business are keen to see it begin, survive and eventually grow. Various barriers, including financial and non-financial problems, hinder their growth. The non-financial barriers include lack of the necessary skills, knowledge and linkages. Lack of cohesive skills training, a skills training policy and strategy are some of the growth barriers. Lack of management training in the SME sector is evidently a constraint to growth as pointed out by Karuri (1992) where he states that the "lack of business management skills was the major constraint in the development of the small scale enterprises". At the formation stage, the owner-manager is able to run his business but as it grows, he needs to delegate tasks to employees with skills in business management. These include finance, sales, production and human resource management in order to meet the growing needs of the firm. Another barrier to growth as pointed out in the Global Competitiveness Index (GCI) Report (2007) is that the current Kenyan training curricular is obsolete and there are major deficiencies in the public training facilities and instructional capacities.

Training is a key factor for enhancing growth and competitiveness of SMEs in Kenya. This applies particularly to entrepreneurs in Africa, Kenya included, where enterprise have remained small over the years (Leidholm, 1998). The Government realised the importance of entrepreneurship training and Sessional Paper No 1 of 1988 was put in place to deal with this

key issue. The paper recommended that entrepreneurship training be introduced in technical institutions and university level. Entrepreneurship training programs were, however, introduced earlier by various non-governmental organizations, private voluntary organizations and private training and consultancy firms. The Ministry of Trade and Industry, through the Kenya Industrial Estates (KIE), conducts various training programmes (GOK, 1988). Business management training programs are offered by a number of institutions in Kenya. Some of these include the British Council, which offered Business Start Up and Business Growth Training to entrepreneurs throughout the country under the *Mwezi Kali* programme. The Kenya Institute of Management (KIM), through the Centre for Enterprise Development, offers various training programs, such as business management, business start-up and a business plan competition branded *Jitihada*started in 2009. Academic programs in entrepreneurship development are offered at various universities in the country, for example, Jomo Kenyatta University of Agriculture and Technology and Kenyatta University offer the course at post-graduate levels. To facilitate growth in the SME sector, training programs implemented in the country should be designed according to the sector"s needs to address its challenges.

The training sector has generally proven to be incapable of responding to the changing needs of the labour market. The rapid growth of the labour force in many African countries, Kenya included, in the 1990s has resulted in the decrease of formal sector employment. In 1994, public sector employment declined from 36 percent to 21 percent and modern private sector employment from 54 percent to 24 percent (Ikiara and Ndung"u, 1999). As a result, more people are forced to engage in informal activities to supplement existing incomes (ILO, 2001). At the same time, purchasing power has seriously declined, especially among lower and middle classes. The purchase of goods and services from the MSE in turn declined. In

order to remain competitive, there was need to improve productivity and quality through skills development. The training offered is still focussed on the needs of wage-employment, while requirements for self-employment (e.g. basic management skills) are still inadequate (ILO, 2001). Hankinson (1994) in his research of small firms in the UK, found that only 25 per cent of respondents were engaged in meaningful training. The following types of training, in order of importance attached by firms, were most common: computing, health and safety, marketing and just-in-time (JIT). In Kenya, for instance, the number of new entrants in the labour market is estimated at 500,000, while the total training capacity is thought to reach some 33,000 or less than 7 percent. The majority of those working in the informal sector are in need of skills upgrading. Few studies were found that chart the exact training needs of the MSE sector (GOK, 1999).

Policies to stimulate the development of the MSE sector in Kenya have been formulated, but the implementation of these policies is still seriously lagging behind (ILO/EAMAT 1996). There is institutional confusion on SMEs responsibilities within Government ministries and agencies. This has resulted in entrepreneurship components scattered in several ministries: Industrialization, Local Government, Youth Affairs and Labour. The situation of the informal sector has improved in recent years. There is more recognition on the part of the Government for the important role it plays in providing incomes and employment to large numbers of the population. Government policies have improved although their implementation and lack of analytical capacity have remained weak.(Mullei and Bokea 1999). This in turn makes it difficult to measure the impact of business skills education.

Most entrepreneurs and artisans acquire skills through on-the-job training and apprenticeship. The World Bank (1992) estimated that 40 percent of all trainees acquire their skills through

apprenticeship The duration of the training varies depending on the kind of trade or skill one is going in for (Twoli and Maundu, 1994). There is urgent need for training in the MSE sector to be demand-driven in order to take care of the changing demand for skills in the labour market by employers. This can be done by introducing appropriate and relevant small business courses for the job market. To prepare new entrants into the informal sector, technical skills training should be complemented with business skills development (GOK, 1999).

Training for the informal sector should be fundamentally different from training in the formal sector as it is characterised by a very close link with production, a distinct target group approach and an unconventional delivery for immediate results (Fluitman, 1989). This is also emphasized by the ILO (2001) that training for the informal sector should not be rigidly structured and examination-based long-term training provided in the past. The training courses should be short and modularized, a mixture of technical and business skills, and conducted in evenings and weekends. This can be done by revising the curriculum to include business skillstraining and the mode of training delivery. Hogarth-Scott and Jones (1993) pointed out that the majority of small business owners would have preferred to have attended a course on running a business prior to the commencement of their trading. This is perceived as the immediate need, and subjects focusing on finance and accounting were considered most relevant. There appears to be great demand for various specialised training programmes in the SME sector. This depends on the individual entrepreneurs and the stages they are at in their respective businesses. Through training, the quality of the products and services is expected to improve. However, business development services are required to deliver services that are demanded by the market place (Tanburn, 2000). Skills have to be upgraded

with the changes in the environment. The SMEs know what training they want and they should be involved in the design and implementation of the courses (Hogarth-Scott & Jones, 1993).

2.5   Theoretical Framework

This study will guided by the resource-based theory postulated by Thomas, (2003) which states entrepreneurs have individual-specific resources that facilitate the recognition of new opportunities and the assembling of resources for the venture. By focusing on resources, from opportunity recognition to the ability to organize these resources into a firm and then to the creation of heterogeneous outputs through the firm that are superior to the market, we help identify issues that begin to address the distinctive domain of entrepreneurship.

This theory is relevant to this study because it clearly shows that the performance of an SME depends on the financial support it gets from financial institution. MFIs play a crucial role in the financing the SMEs. Many entrepreneurs will be able to start their businesses because of the financial support that the microfinance institutions will offer them. MFIs will also be involved in other activities that will be geared towards helping the SMEs to effectively run their businesses. Some of these programs will include the managerial and advisory services that will usually offered in form of training and seminars. The SMEs will be trained on how to manage their enterprises in professional ways that can lead to the enterprises realizing their business objectives of improving their performance. The MFIs also carry out market research to get important information they can give to the entrepreneurs on the best ways they can operate their businesses profitably.

2.6   Conceptual Framework

The study is based on conceptual framework, where the researcher identifies the dependent and independent variable. The conceptual framework below clearly indicates that the microfinance industry provides a wide range of financial services (loans, savings, micro insurance, leasing, mortgaging and money transfer) and Non-financial services (advisory, references, training, counseling, social corporate responsibility, business culture and ethics, business customer care and business location), which services and products affect the growth of SMEs. The performance (growth) of the SMEs in Nakuru could be spurred with the stable financial and non-financial services and products from the MFIs because of their outreach programs. Other intervening factors that impact on the growth of SMEs in Kenya include the levels of inflation, interest rates, and unemployment, taxation, competition and foreign exchange dealings. The presence and favorability of these factors could act as a catalyst in the growth of the SME sub sector and poverty reduction in Kenya. The dependent variables will the performance of SMEs and the independent variable will be micro-finance services towards the small enterprises.

Independent Variable
(Micro-Finance Services)

Dependent Variable
(SMEs Performance)

Cost of credit
✓ Investments
✓ creditworthiness

Non-repayment of MFI's loans
✓ Bad debts
✓ High interest rates

Trainings offered by MFIs
✓ Efficiency
✓ Competence
✓ Productivity

Performance of Small and Medium Enterprises
✓ Profitability ratios

✓ **Inflation**
✓ **Interest rates**
✓ **Competition**
✓ **Organizational Policies**
✓ **Level of subsidies**

Figure 2.1; Conceptual Framework

Source: Researcher, 2016

The conceptual framework shows the relationship between MFIs services or products and business growth. With these financial and non-financial services, SMEs should be able to acquire loans to expand their business stock, acquire fixed and current assets, increase on profitability, widen their savings deposits for purposes of capital accumulation, create employment opportunities through business expansion and growth, improvement on business skills competencies and financial literacy through MFI financial education and counseling packages. However, there are other business environment factors outside the boundaries of the microfinance industry that influence the performance of SMEs. The micro business environment factors include; location advantage, business experience, customer care and business ethical considerations. On the other hand, the macro business factors are; interest rate, exchange rate, inflation, and unemployment, fiscal and monetary policies. The growth and development of SMEs is dependent on the variation of the business environment factors on a positive or negative scale.

CHAPTER THREE

RESEARCH DESIGN AND METHODOLOGY

3.1   Introduction

This chapter covers the research design, the target population, sample size and area of study, sampling procedure, research instruments, and data collection procedures and data analysis techniques.

3.2   Research Design

Research design is the plan and structure of investigation so conceived as to obtain answers to research questions. A descriptive study is concerned with determining the frequency with which something occurs or the relationship between variables (Cooper and Schindler, 2003). The study used an exploratory survey design to investigate the effects of MFIs services on the performance of SMEs within Nakuru town. Exploratory research helps determine the best research design, data collection method and selection of subjects, (Patton, 2000).It is an efficient approach of collecting data regarding characteristic of sample of a population, current practices, conditions or needs. The basic idea behind research design was to measure variables by asking the respondents questions and then to examine relationships among the variables. The research design attempted to capture attitude or patterns of the questions being sought.

3.3   Target population

Orodho (2002) defines target population as a large population from whom a sample population is selected. The idea is not far from Mugenda & Mugenda's view as they define a population as the entire group of individuals, events or objects having a common observable characteristic. The target population of this study was all SME's in Nakuru town Central Business District. The target respondents in this study were 84 SME's owners.

3.4   Sample size and sampling procedure

This study collected data from all the SME's within Nakuru Central Business District as this method provided a more suitable benchmark data on the effects of MFIs' services on the SMEs' performance. This is because the data is more accurate and reliable as it takes into account the entire population.

3.5   Data Collection Instruments

Schindler (2006) recommends the use of questionnaires in descriptive studies because self-administered surveys typically cost less than interviews and sample accessibility is easy. This study utilized a questionnaire to collect primary data using drop and pick method. The instrument was of five point Likert scale format. Closed ended questions were preferred to open ended questions since they are easier to code and analyze.

3.6   Data Collection Procedures

Authorization letter to carry out the research was sourced from the School of business. The information obtained from the respondents will be treated with utmost confidentiality. Before the actual data collection exercise takes place, the researcher undertook a preliminary survey within Nakuru town to familiarize with the study area. The researcher distributed the questionnaires to the respondents and collected them immediately after the exercise to ensure efficiency in collection of the data.

3.6.1   Validity and Reliability of the Research Instrument

Validity is the extent to which a measuring instrument measures what it claims to measure. It is whether an instrument measures the traits, characteristics, quality or whatever for which it is intended to measure (Singh, 2012).

Reliability is a measure of the degree to which a research instrument yields consistent results or data after repeated trials (Babbie, 2010). The researcher used Cronbach's alpha (also called Coefficient alpha) to establish the internal consistency of the quantitative items in the

questionnaire. This is because the use of Cronbach's alpha enables the researcher to obtain the internal consistency from the administration of a single form of test once to gauge its reliability (Suter, 2006). "The Cronbach's alpha estimate also tells us how highly the items in our questionnaire are interrelated" (Hayes, 2008).

In this study reliability was done using cronbach alpha test. The main objective of this test was to measure the internal consistency of the study components, which is, how closely related a set of components are as a group.The Internal consistencies of all variables were considered acceptable since they exceeded 0.70, signifying tolerable reliability. The overall reliability was 0.814 based on Cronbach's alpha, 0.813 based on standardized items and with 12 numbers of items tested, from the eleven (11) questionnaires administered to the SMEs' pilot sample.

3.7   Data Analysis Procedures

The researcher employed the use of descriptive and inferential statistic in analysing the data. Descriptive statistics employed the use of measures of central tendency such as mean in the analysis of the data. In the representation of the data the researcher employed the use of frequencies tables, percentages and charts. Descriptive statistics was used to explain the research findings and characteristics of the respondents. Inferential statistics was employed through the use of chi-square to identify the relationships between the variables under study and their effects on SMEs performance.

Multiple regression used was based on the model below where three main services offered by MFIs namely cost of credit, Non Repayment and training were considered.

$Y = \alpha + \beta_1 X_1 - \beta_2 X_2 + \beta_3 X_3 + \varepsilon$

Where;

47

Y= performance of SMEs as measured by the profitability ratios,

α = autonomous performance

X_1= cost of credit SMEs on their performance based on likert scale. Most SMEs require debt in order to finance growth as equity financing is rarely sufficient but traditionally, the higher the level of gearing, the higher the level of financial risk.

X_2= Non Payment of loans measured by retained earnings to total assets and perception of its effects on financial performance of SMEs based on likert scale.

X_3= Training on investment and other skills as measured perceptually by use of likert scale.

ε = an error term.

The study employed R^2 to test the significance of the above model. R^2 is the coefficient of determinant expressed in percentage and shows the variability in the dependent variable explained by variability in the independent variables. Since there was possibility of getting variance due to chance associated with the use of more independent variables thus the model was tested and adjusted by the use of R^2

CHAPTER FOUR

DATA ANALYSIS, PRESENTATION AND DISCUSSION

4.1   Introduction

This chapter presents the data analysis, presentation and interpretation of findings on the data collected from respondents on the Effects of Micro-Finance services on the performance of Small and Medium Enterprises performance. The main objective of the study was to determine effect of MFI's cost of credit on the performance of SMEs, to determine the effect of non-repayment of MFI's loans on the performance of SMEs and to evaluate the effect of trainings offered by MFIs on SMEs' performance in Nakuru town.

4.2   Response rate

The researcher distributed a total of 84 questionnaires to the respondent out of the 84 questionnaires 66 were filled and returned. The rates of return of questionnaires for the SME's are presented in Table 4.1. Out of the 84 questionnaires issued, 66 were returned giving a 79% response rate as shown in Table 4.1. According to Mugenda and Mugenda (2003) a 50% response rate is adequate, 60% good and above 70% is rated very good. This implies that based on these assertions; the response rate for this study, 79% is very good.

Table 4.1; Response Rate

Response Rate	Questionnaire administered	Questionnaires filled and returned	Percentage
Total	84	66	79

4.3   Demographic information

The study found it important to establish the demographic information in order to evaluate the Effects of Micro-Finance services on the performance of Small and Medium Enterprises

performance. The demographic information of the respondents included gender, Age and length at work

4.3.1 Gender of the respondent

The researcher sought to determine the gender distribution of the respondents and the findings are shown in figure 4.1
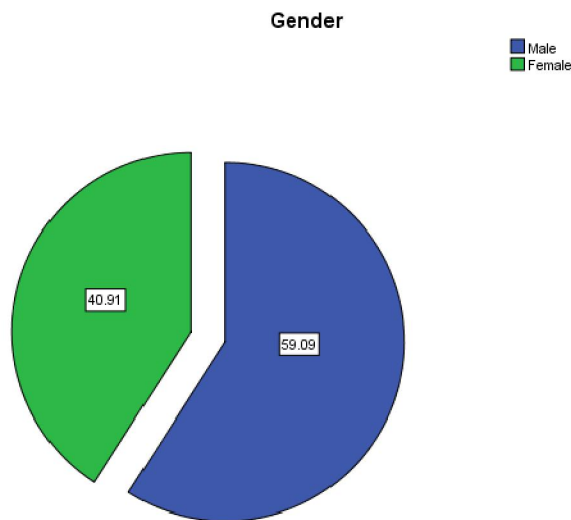
Figure 4.1: Gender

The findings of the study indicated that the dominant group, the majority of the respondents who participated in the study, was male who accounted for 59% while their female counterparts accounted for 41%.

4.3.2 Length of service

The researcher found it important to ask the respondents to indicate their length of service. Duration of service to an organization establishes the respondents' degree of familiarity with their organization's operations in terms of their economic position as well as the organization's obligations and policies. Evaluating the length of the respondents, the study

50

established that those who had worked for less than 2 years were 23%, and majority of respondents cited having worked for 3 < 5 years were 56% while those with above 10 years were 20%. Work experience was found to be valuable in providing relevant information on the determinants of SME's performance
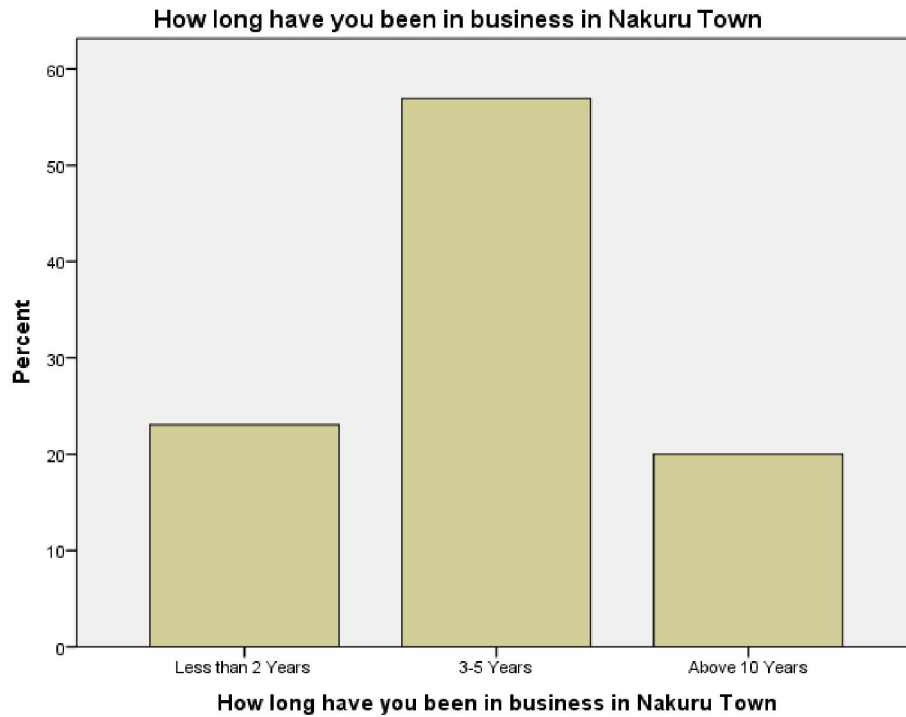
Figure 4.2; Length In business

4.3.3 Age

Different ages could have diverse perspectives of experiences at the work place that affect their performance. Therefore, it was important to establish whether different age groups had different levels of performance. Information on age determines to whom research findings generalize and allows for comparisons to be made across replications of studies (Bein, 2009).
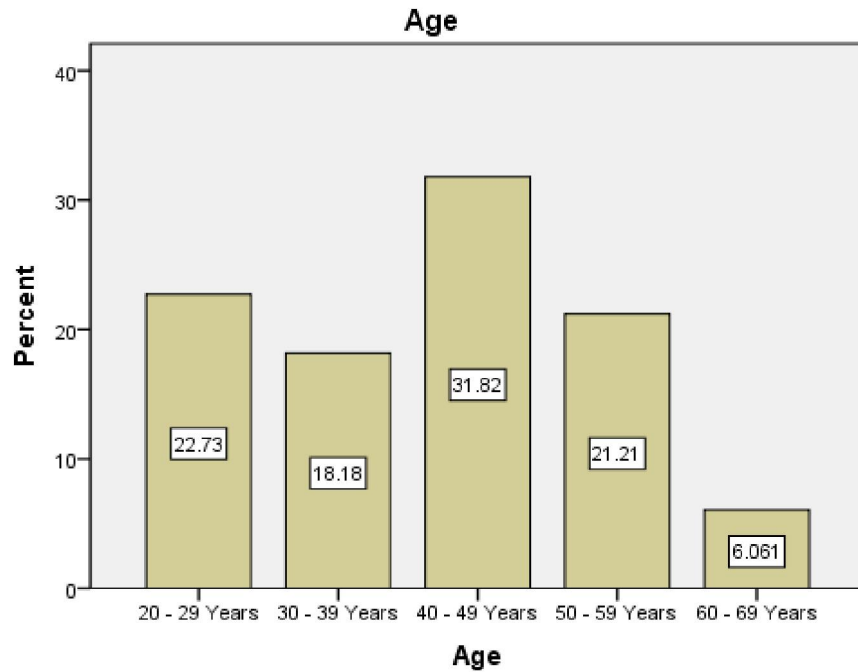
Figure 4.3; Age

Figure 4.3shows the dominant age brackets of 40 to 49 32% of the respondents. The age bracket of 20 and 29 follows at 23% while the brackets of 50 to 59 trail at 21%. The age groups of 30 to 39 years are indicated at 18% while 60 to 69 is at 6%. The results displayed in Figure 4.3 indicated that the SME's had all working age groups represented among them. The majority of respondents were three years and above which shows that they had experience in the field.

4.4 The Findings of the Study

The findings of the study were related to the four research questions and the responses attained from questionnaires. The study findings on the research questions covered aspects of cost of credit, effects of non-repayment, training and performance. The first research question sought to determine the effect of MFI's cost of credit on the performance of SMEs in Nakuru town. The study sought to analyze the relationship between costs of credit as a factor influencing performance. The objective was achieved by asking the respondents to respond to

questions that best described their immediate environment. According to Nachmias and Nachmias (2003), Likert scaling is a method designed to measure attitudes. The researcher prepared a Likert scale and computed a total score for each respondent. These together with other items were each rated on a 5-point Likert scale ranging from: 1= Strongly Agree to 5= Strongly Disagree and the results summarised and presented.

Table 4..2; Likert Scale Summation of cost of credit

Likert items	SA %	A %	N %	D %	SD %	χ^2	p-value
Interest rates charged on microfinances are very high	34(52)	21(32)	5(8)	2(3)	2(3)	140.89	0.001
Interest rates charged on microfinances are fair and affordable	14(21)	26(39)	12(18)	8(12)	4(6)	86.138	0.001
Interest rates charged on microfinances ahave reduced my financial costs	17(26)	19(29)	14(21)	10(15)	2(3)	48.638	0.001
Interest rates charged on microfinances have improved the cash flow position of my business	19(29)	19(29)	8(12)	8(12)	10(15)	36.431	0.001
Interest rates charged on microfinances have positively affected the business profitability	23(35)	19(29)	10(15)	8(12)	4(6)	50.397	0.001
Conditions set by financial institutions are flexible	20(30)	12(18)	9(14)	7(11)	16(24)	51.534	0.001

Source: Research Data, 2016

Table 4.2 indicated that majority of the respondents (χ^2 =140, P≤0.001) strongly agreed that interest rates charges on microfinance are very high. On Interest rates charged on microfinances are fair and affordable the respondents agreed (χ^2 =86.13, P≤0.001) while another 29% agreed (χ^2=48 P≤0.001) that interest rates charged on microfinances have reduced their financial costs. On Interest rates charged on microfinances have improved the cash flow position of my business the respondents strongly agreed (χ^2 =36, P≤0.001). on the statemement while another 35% also strongly agreed (χ^2 =50, P≤0.001) that Interest rates charged on microfinances have positively affected the business profitability. On Conditions set by financial institutions are flexible the respondents strongly agreed (χ^2 =51,

P≤0.001) on the same. In consideration of the above outcome, all the questions were significant and there is high probability that cost of credit is an influence on the performance of SME.

Table 4.3; Likert Scale Summation of Non-repayment

Likert items	SA %	A %	N %	D %	SD %	χ^2	p-value
Lack of information is a common factor in defaulting payment	25(38)	22(33)	5(8)	5(8)	8(12)	86.897	0.001
Lack of access to credit has impact on defaulting	11(17)	30(46)	5(8)	8(12)	9(14)	141.75	0.001
Inadequate guarantees negate loan repayment	19(29)	14(21)	12(18)	8(12)	10(15)	65.293	0.001
There is clear guidelines and directions on payment	21(32)	26(39)	7(11)	4(6)	4(6)	75.793	0.001
There is flexible time allowance on repaying loans	19(29)	20(30)	10(15)	6(9)	9(14)	115.98	0.001
Hidden charges influence non repayment of loans	34(52)	15(23)	4(6)	2(3)	9(14)	81.448	0.001

Source: Research Data, 2016

Table 4.3 shows the responses of respondents views and opinions on Lack of information is a common factor in defaulting payment strongly agreed (χ^2 =86.897, P≤0.001). Another 46% agreed(χ^2 =141.759, P≤0.001) that Lack of access to credit has impact on defaulting while 29% indicated (χ^2 =65.293, P≤0.001) that Inadequate guarantees negate loan repayment was a factor. The findings aslo show that 39% agreed(χ^2=75.793, P≤0.001) there is clear guidelines and directions on payment while another 30% said that There is flexible time allowance on repaying loans. Hidden charges influence non repayment of loans was indicated as 52% stongly agreed(χ^2 =81.448, P≤0.001). In consideration of the above outcome, In consideration of the above outcome, all the questions were significant and thus there is high likelihood that Non-payment of loans is an influence on the performance of SME.

Table 4.4; Likert Scale Summation of training

Likert items	SA %	A %	N %	D %	SD %	χ^2	p-value
There is increase in productivity from training received	25(38)	33(50)	3(5)	2(3)	1(2)	72.621	0.001
The learning curve and growth has improved	25(38)	31(47)	6(9)	2(3)	-	98.569	0.001
Competency of staff has increased	24(35)	30(46)	5(8)	5(8)	-	55.897	0.001
Customer satisfaction index has improved due to training	23(35)	30(46)	5(8)	5(8)	-	80.81	0.001
Efficiency and effectiveness have eased work operations due to training	20(30)	34(52)	6(9)	3(5)	1(2)	76.43	0.001

Source: Research Data, 2016

The finding in table 4.4 indicate that majority of the respondents agree (χ^2 =72.621, P≤0.001) that there is increase in productivity from training received while another 47% agreed(χ^2 =98.569, P≤0.001) also that The learning curve and growth has improved. 46% of the respondents also indicated (χ^2 =55.897 P≤0.001) that Competency of staff has increased and another (χ^2 =80.81, P≤0.001) said thatCustomer satisfaction index has improved due to training. On Efficiency and effectiveness have eased work operations due to training the majority of the respondents agreed (χ^2 =51, P≤0.001) to that statement., In consideration of the above outcome, all the questions were significant and thus there is high likelihood that training is an influence on the performance of SME

Table 4.5; Likert Scale Summation of performance

Likert items	SA %	A %	N %	D %	SD %	χ^2	p-value
Management competency influence is an important factor	29(43)	27(41)	4(6)	3(5)	-	61.759	0.001
There is a significant impact of internal business process perspectives on the performance	23(35)	30(46)	8(12)	2(3)	-	60.983	0.001
There is a positive impact of financial perspectives on the performance	18(27)	31(47)	5(8)	4(6)	2(3)	83.914	0.001
There is a significant impact of customer perspective on the performance	23(35)	35(53)	2(3)	3(5)		78.31	0.001
Accountability is key to financing	28(42)	25(38)	7(11)	1(2)	2(3)	43.33	0.001
Access to finance has been made easy	29(44)	24(36)	5(8)	3(5)	2(3)	54.44	0.001

Source: Research Data, 2016

The findings in Table 4.5 indicate that 43% of the majority of the respondents agreed that Management competency influence is an important factor while 46% indicated that there is a significant impact of internal business process perspectives on the performance. On There is a positive impact of financial perspectives on the performance the respondents agreed 47% while another 53% indicated that There is a significant impact of customer perspective on the performance. On Accountability is key to financing 42% of the respondents agreed while 44% indicated that Access to finance has been made easy.

4.5   Inferential statistics

Inferential statistics makes inferences about populations using data drawn from the population in an effort to reach conclusions that extend beyond the immediate data alone.

4.5.1   Correlation analysis

Correlation coefficients measure the strength of association between two variables. A positive correlation indicates the extent to which those variables increase or decrease in parallel; a negative correlation indicates the extent to which one variable increases as the other decreases. To be precise, it measures the extent of association between the ordering of two random variables although; a significant correlation does not necessarily indicate causality but rather a common linkage in a sequence of events. Thus, the study analyzed the relationships that are inherent among the independent and dependent variables as well as among the independent variables/ factors. The results regarding this were summarized and presented in table 4.7

Table 4.7: Summary of Correlation

		Cost of credit	Non-Repayment	Training	Performance
Cost of credit	Pearson Correlation	1			
	Sig. (2-tailed)				
	N	84			
Non-Repayment	Pearson Correlation	.701**	1		
	Sig. (2-tailed)	.000			
	N	84	84		
Training	Pearson Correlation	.721**	.653**	1	
	Sig. (2-tailed)	.000	.000		
	N	84	84	84	
Performance	Pearson Correlation	.670**	.590**	.621**	1
	Sig. (2-tailed)	.0001	.000	.000	
	N	84	84	84	84

A correlation analysis to determine whether cost of credit had an influence on increase in performance shows a positive and significant relationship exist(r=0.670, α = 0.01). This suggests that cost of credit was an important factor in improving performance.

The correlation analysis to determine whether non-payment had an influence on shows a relationship exist(r = 0.590 α = 0.01). This implies that non-payment were significant to increased performance.

The study also sought to determine whether training had influence increase in performance shows a positive and significant relationship exists (r = 0.621 α =0.01). The relationship is high suggesting training being a significant factor in increased performance.

It can therefore be concluded that all the variables were significant to the study problem although the degrees of influence varied.

4.5.2 Regression

A Multiple linear regression model was used to predict increase in performance in the study. The coefficient of determination, r^2, is useful because it gives the proportion of the variance (fluctuation) of one variable that is predictable from the other variable. It is a measure that

allows us to determine how certain one can be in making predictions from a certain model/graph. The coefficient of determination is the ratio of the explained variation to the total

variation. The coefficient of determination is such that $0 \leq r^2 \leq 1$, and denotes the strength of the linear association between x and y. The coefficient of determination represents the percent of the data that is the closest to the line of best fit.

The prediction was carried out basing on the effect of the three independent factors: cost of credit, non-repayment and training. In addition, the b coefficients for each independent variable generated from the model was subjected to a t-test, in order to test each of the hypotheses under study.

Table 4.6; Regression Model

Model	R	R^2	Adjusted r^2	Std. Error of the Estimate
0.804	0.647	0.638	0.56069	1.929

 a. Predictors: (Constant), Performance
 b. Predictors: (Constant), cost of credit, Non-payment & Training

The adjusted R^2 is an indicator of generalizability as it is used to estimate the expected shrinkage in R^2 that would not generalize to the population because of the solution being over-fitted to the data set by including independent variables.

From table 4.6, the findings indicated that If $r = 0.647$, then $r^2 = 0.638$, which means that 63% of the total variation in y can be explained by the linear relationship between x and y (as described by the regression equation). The other 37% of the total variation in y remains unexplained. The *coefficient of determination* is a measure of how well the regression line represents the data. If the regression line passes exactly through every point on the scatter plot, it would be able to explain all of the variation. The further the line is away from the points, the less it is able to explain.

4.5.3   Anova

The probability value (p-value) of a statistical hypothesis test is the probability of getting a value of the test statistic as extreme as or more extreme than that observed by chance alone, if the null hypothesis H0 is true. The p-value is compared with the actual significance level of the test and, if it is smaller, the result is significant. The smaller it is the more convincing is the rejection of the null hypothesis.It attempts to determine if there is a statistically significant difference between the groups that is not related to sampling error. This is to say, all groups might be different, or perhaps only one of four groups is statistically different from the others.

The Anova model in table 4.7 showed that the regression model was also adequate. ANOVA uses F-tests to statistically test the equality of means. The effect size of the regression model was shown to be over 75 that contributed by the residual mean sum of squares. The F-ratio was 75.739 at 4 degrees of freedom which are the four factors. This represented the effect size of the regression model and was significant with a p-value of 0.000.

Table 4.7; Summary of Anova Table

Source Of Difference	Sum of squares	df	Mean Square	F	Sig.
Between groups	119	7	23.81	75.739	0.000
Within groups	65.075	267	0.314		
Total	184.124	284			

Note: df = degrees of freedom; F = Anova; α = level of significance; Fo = calculated value of F; Fc = the critical value of F; αo = calculate value of α; and αc = the critical value of α.

The ANOVA analysis is intended to investigate whether the variation in the independent variables explain the observed variance in the outcome – in this study the performance of SME's. In this context, as have been presented in the table above, the dependent variable is

the level of performance whiles the independent or the predictors, cost of credit, Non-payment & Training.

4.6   Coefficients Model

Regression coefficients represent the mean change in the response variable for one unit of change in the predictor variable while holding other predictors in the model constant. This statistical control that regression provides is important because it isolates the role of one variable from all of the others in the model.

Table 4.8; Coefficients Model

	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
	B	Std. Error	Beta			Tolerance	VIF
(Constant)	.167	.042		3.992	.000		
Cost Of Credit	.407	.092	.485	4.408	.000	.806	1.241
Non Repayment	.172	.058	.189	2.982	.003	.875	1.143
Training	.065	.075	.086	.867	.001	.077	1.298

Dependent Variable: Increase in performance
 Source: Data Results

The regression results in table 4.8 show that each of the predicted parameters in relation to the independent factors were significant; $\beta1$= 0.407 (p-value = 0.000 which is less than α = 0.05) which implies that we reject the null hypothesis stating that there is no significant relationship between cost of credit and performance. This indicates that for each unit increase in the positive effect of cost of credit, there is 0.407 units increase performance. Furthermore, the effect of cost of credit was stated by the t-test value = 4.408 which implies that the standard error associated with the parameter is less than the effect of the parameter.

The table also shows that $\beta2$ = 0.172 (p-value = 0.000 which is less than α = 0.05) which indicates that we reject the null hypothesis stating that there is no significant relationship between non-repayment and performance. This implies that for each unit increase in non-

repayment, there is up to 0.172 unit increase in performance. Also the effect of non-repayment is shown by the t-test value of 2.982 which implies that the effect of non-repayment surpasses that of the error by over 2 times.

The value of $\beta 3 = 0.065$(p-value = 0.087 which is less than $\alpha = 0.05$) which implies that we reject the null hypothesis stating that there is no significant relationship between training and performance. This indicates that for each unit increase in training, there is up to 0.065 units increase in performance. The effect of training is stated by the t-test value = 0.867 which indicates that the effect of training is over 0 times that of the error associated with it.

The rule of thumb was applied in the interpretation of the variance inflation factor (VIF). From table 4.10, the VIF for all the estimated parameters was found to be less than 4 which indicate the absence of multi-collinearity among the independent factors. This implies that the variation contributed by each of the independent factors was significantly independent and all the factors should be included in the prediction model.

CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATION

5.1 Introduction

This chapter presents summary, conclusion and recommendations of the study. The summary mainly contains the key findings. Conclusions and recommendations on its parts are based on the research objective and the key findings of the study respectively.

5.2 Summary of the Findings

The study sought to explore the effects of Microfinance services on performance of Small and Medium scale enterprises in Nakuru town.

5.2.1 Findings on Credit on performance

The study established that there is a positive correlation between cost of credit and performance on the loans and the fairness and affordability of the loans as result of the interest. This means that the high the interest rates the less affordable the loans to SMEs. The study further indicated that the level of interest rates charged on the loans by the MFIs have negative correlation with the parameters of business performance. High interest rates do not reduce the financial cost, improve cash flow as well as increase profitability of the SMEs.

The study also revealed that SMEs borrow investment capital from MFIs. Most of the SMEs do not have other sources of financing their operations as they are usually regarded as uncreditwothy by the formal commercial banks on the ground that they lack collaterals and also formal commercial banks see them as costly because of the nature of their business transactions. Nevertheless some SMEs have other sources of finance like personal savings, borrowing from family and friends and lastly through inheritance.

The study further revealed that services received from the MFIs led to increase in sales, profits, increase in assets and retained earnings. ROA increased with the subsequent borrowing showing that the assets were well used to generate profits hence the study concludes that microfinance services enhance financial performance of SMEs in Kenya.

5.2.2 Findings of Non-Repayment on Performance

The study found that MFIs should increase the sizes of loans so that SMEs can undertake major investments in their businesses. MFIs should provide loans with flexible loan repayment terms, MFIs should reduce interest rates on loans, Reduction in the time taken to disburse loans and should provide long term loans to reduce pressure on SMEs in loan repayment;. Improving services to meet the different needs of SMEs; and revising the conditions under which loans are given to SMEs.

In a study conducted in Kenya among youth entrepreneurs, Simeyo *et al.* (2011) found that micro-entrepreneurs who secured funds from micro-finance institutions spent the bulk of their returns on their investments in paying off the cost of the capital, thus leaving them with none or little savings for reinvestment. Although it is believed that micro-finance has a positive effect, it is also clear that there are negative side effects (Kiweu, 2011:88). Overall, the effect of micro-finance institutions on small and medium enterprises can be positive or negative (Simeyo *et al.* (2011). Furthermore, the impact of micro-finance on small and medium enterprises has not received adequate empirical research attention.

5.2.3 Findings on Training on performance

The study found that training as a component helps clients and the organisations alike to minimize transaction related risks. The study also found out that SMEs must put more effort to change the owner managers' perception of training from being a "cost' to being an "investment". Training must be regarded as an investment instead of a cost. Only by having

this new perception it is expected the demand for training will increase from SMEs, and in turn they will become more efficient and contribute more effectively to the economy of the country at national level.

Respondents were in agreement that training on how to handle services and clients was the main constraint to obtaining a micro-loan. Factors that influenced the choice of a micro-finance institution were the influence of friends followed by the availability of credit and the location of micro-finance institutions.

The study established that MFIs have provided support services for SMEs in the form of business, financial and managerial training. As most SMEs lack the requisite knowledge and some have little knowledge in financial management, this sort of training had beneficiaries make informed financial decisions.

5.3   Conclusion

Based on the findings, the study concludes that the performance is due to changes in cost of credit, on-repayment of loans and training provided by MFIs. The results show the relationship between the micro finance services and the growth of SMEs. There is a strong positive relationship between the micro finance services and the SMEs Growth. The study further concludes that Microcredit and Training provided to SMEs leads to their high growth. It can also be concluded that there is a major effect of the micro finance services on the growth of SMEs in Nakuru County. This concurs with Koech (2011) that the factors affecting growth were capital market, cost, capital access, collateral requirements, information access, capital management and cost of registration. Capital market, cost and capital access had the highest contribution to constraining SMEs growth into large businesses. It also agrees with

the findings of Cooper(2012) that microfinance services had a strong positive impact on the growth of SMEs.

5.4   Recommendations for Policy

Based on the key findings, the study made the following recommendations. Microfinance Institutions should enhance training of their clients on the entrepreneurial skills so as to enhance their skills as a large proportion of the respondents were found to be certificate holders of high school graduates hence they lacked the necessary business management skills. The government should invest heavily in education and if possible offer free or subsidized entrepreneurial training especially for the secondary school graduates who are unable to proceed to university or any other tertiary education.

MFIs should market their newly lunched products such as school fees loans, payment facilities and insurance so that their clients can take full advantage of the same. This will lead to balanced life style of the youths as they will be able to make savings that can be used for expansion purposes of their business other than spending on other non-business line as treatment and school fees.

The MFIs should find the ways to reduce the interest rate for the loan they offer to the entrepreneurs so as to increase the profit margin to the borrowers. The unions are advised to provide the longer grace period to the entrepreneurs before they start to recover their loan. This is because some project like poultry project takes not less than 3 months before selling, so, how does the borrower gets the money to repay after one month grace period? It is obviously very difficult. The MFIs should give enough loans and allocate substantial budget in order to provide more training to the entrepreneurs on doing business efficiently. The MFIs

should reduce the long and tiresome procedures when people want to get loans. Although not many, only a few have complained of a delay and long period taken to process the loans which need to be improved.

Another issue which need immediate attention from policy makers is to come up with the policy which will promote and nature the domestic entrepreneurs by encouraging them, protecting their market from external similar products, financing them and not leaving this duty to MFIs only who also seek profit from these poor people so that they can be given time, physical and financial environment to grow.

The borrowers are advised to utilize the borrowed fund for the proposed aims and not otherwise. They should have prior plan before getting loan and to abide by the initial plan; they should not change their plans upon securing loans. This will enable them to repay the loans and avoiding confiscation of their properties. Members are also advised to learn and apply entrepreneurial skills and apply them in doing their business. They should also follow all principles required in doing businesses.

5.5   Recommendations for Further Research

Since the study focused on micro finance services on the performance of SMEs in Nakuru County, it is suggested that further studies be done on other Counties. This is because different counties have unique characteristics and diverse contextual realities that might affect micro finance services offered to SMEs. It is also recommended that a study be done to find out why many SMEs do not make use of the micro insurance. The study further recommends that for studies require information about business growth and business records the data collection tools be designed to seek both facts and opinions.

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Questionnaire

Dear Respondent,

I am a student undertaking research on the effects of MFIs funding on SMEs performance. I kindly request you to fill in the questionnaire appropriately. The information provided will be kept confidential and will be used for academic purpose only.

Thank you,

Section A: Demographics

(Please tick where necessary)

i. Gender

      Male   ☐   Female   ☐

ii. Age

      18 – 30 Years ☐   31-45 Years   ☐

      Above 45 Years   ☐

iii. How long have you been in business Within Nakuru town?

      a. Less than 2 years   ☐

      b. 3-5 years   ☐

      c. 6-10 years   ☐

      d. Above 10 years   ☐

SECTION B

PART I: COST OF CREDIT.

You are kindly requested to state your degree of agreement or disagreement to each of the given items on a 5-point Likert scale. Insert a cross (x) in the most appropriate column. Use the key below when responding.

SA   =   **Strongly Agree**
A   =   **Agree**
N   =   **Neutral**
D   =   **Disagree**
SD   =   **Strongly Disagree**

To what extent do you agree with the statement about Cost of Credit?

Cost Of Credit.	SA	A	N	D	SD
Interest rates charged on microfinance loans are very high					
Interest rates charged on microfinance loans are fair and affordable					
Interest rates charged on microfinance loans have reduced my financial costs.					
Interest rates charged on microfinance loans have improved the cash flow position of my business					
Interest rates charged on microfinance loans have positively affected the business profitability					
Conditions set by financial institutes are flexible					

PART II: NON REPAYMENT OF LOANS

To what extent do you agree with the statement about Non Repayment of Loans?

Non Repayment of Loans	SA	A	N	D	SD
Lack of information is a common factor in defaulting payment					
Lack of access to credit has impact on defaulting					
Inadequate guarantees negate loan repayment.					
There is clear guidelines and directions on payment					
There is flexible time allowance on repaying loans					
Hidden charges influence non repayment of loans					

PART III: TRAINING

You are kindly requested to state your degree of agreement or disagreement to each of the given items on a 5-point Likert scale. Insert a cross (x) in the most appropriate column. Use the key below when responding.

To what extent do you agree with the statement about Training?

Training	SA	A	N	D	SD

There is increase in productivity from training received					
The learning and growth perspective has improved					
Competency of staffs has increased					
Customer satisfaction index has improved due to training.					
Efficiency and effective have eased work operations due to training					

PART IV: PERFORMANCE

You are kindly requested to state your degree of agreement or disagreement to each of the given items on a 5-point Likert scale. Insert a cross (x) in the most appropriate column. Use the key below when responding.

To what extent do you agree with the statements about performance?

PERFORMANCE,	SA	A	N	D	SD
Management competency influences is an important factor					
There is a significant impact of internal business process perspective on the performance					
There is a positive an impact of financial perspective on the performance					
There is a significant an impact of customer perspective on the performance					
Accountability is key to financing					
Access to finance has been made easy					

Thank you for your co-operation and time.