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Effects of Microfinance Institutions' Products on Financial Performance of Small and Medium Enterprises; A Case of Machakos Town, Kenya

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Abstract: *Vision 2030 has emphasized the importance of SMEs in Kenya. Small and Medium Enterprises are noted as a crucial catalyst for achieving vision 2030. This research on the effects of Microfinance institutions` on financial performance of small and medium enterprises was done in Machakos town, where the general objective of the research was to determine whether there was any significant effect of Microfinances` products on the financial performance of small and medium enterprises in Machakos town. Descriptive research design was employed since the researcher collected information through descriptions and this design is also useful for identifying variables and hypothetical construction. Stratified random sampling technique was used, and the sample size was determined as 372, at 95% confidence interval. Primary data was collected through questionnaires issued to the owners and managers of SMEs, which were then collected later. Data analysis was done through a regression equation which analyzed the relationship between Microfinances` products and financial performance of small and medium enterprises. The results showed that, the MFIs` products offered (micro savings, micro credit, micro insurance and training) have effects on the financial performance of SMEs. The study recommended that MFIs have a great responsibility of ensuring the proper use of credit which is an important facility in financial performance of businesses. To achieve this, credits should be SMEs-oriented and not product- oriented. Proper and extensive monitoring activities should be provided to SMEs who are granted the micro credit product. MFIs can research into very profitable business lines and offer credit to SMEs who have the capacity to exploit such business lines, micro insurance is paramount to SMEs in cushioning them in the event of unfavorable occurrence, and should be enhanced properly to the SMEs, and that business and financial training should be provided by MFIs on a regular basis and most cases should be tailored toward the training needs of the SMEs.*

I. Introduction

Background to the Study

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

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

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

MFIs in Kenya have a large number of low income households and MSEs in the rural and urban areas of Kenya. MFIs gained prominence in Kenya due to the fact that the formal banking sector since independence

up to late 2000 regarded the informal sector as risky and not commercially viable (Ogindo, 2006). The MFIs developed and offered new, innovative and pro-poor modes of financing low-income households and MSEs based on sound operating principles. Since their inception, MFIs have greatly contributed to social-economic empowerment to the beneficiaries and their dependants (Kamau, 2010).

As the idea of microfinance continued to spread, so many Microfinance Institutions also began to spring up. According to the Association of Microfinance Institutions in Kenya (AMFI), there are 53 microfinance institutions in Kenya, serving about 6.5 million poor Kenyans. Some are banking institutions, NGOs, Christian Organizations and Non-banking Financial Institutions. They are spread across the whole country. However, with the emergence of many MFIs in Kenya, there seem to be some hope for the poor, but some questions that come to mind are: what is the effect of the microfinance products to the poor and more especially those who own small businesses? Have those who contracted the microfinance product and credit rather not been burdened with the problem of repayment and thereby becoming poorer?

The issues at stake are to determine whether the products being provided by these microfinance institutions, have the intended purpose of influencing the financial performance of small and medium enterprises.

Statement of the Problem

Accessing products from large and developed financial institutions in the developing economies by SMEs is not easy (Robinson, 1998). World Bank (2000) reiterates the fact that SMEs are more likely to be denied new loans for their businesses than larger firms when in need. They consider SMEs to lack the skills to manage risk and the high transaction costs in lending to them compared to the amount that is borrowed (Hallberg, 1994). This has become the reason for SMEs turning to MFIs for the products which they could have accessed from commercial banks and other large established financial institutions, due to the friendly terms and products tailored to suit the needs of the small and medium enterprises offered by the microfinance institutions.

Various studies have been done in Kenya on small and medium enterprises and microfinance institutions. Mutuku, (2010) studied on the impact of microfinance institutions on MSMEs in Kenya and found out that they had a great impact on employment creation and poverty alleviation. Ngugi,(2009); Kioko,(2009); Makena,(2011) studied on the financial challenges faced by SMEs and found that inadequacies in access to finance are key obstacles to SMEs growth. Koech, (2011) in a survey of the financial constraints hindering growth of SMEs found that the factors affecting growth were capital market, cost, capital access, collateral requirements, capital management and cost of registration. Studying on the relationship between microfinance services and performance of SMEs, Kemei, (2011) found that positive and significant relationships have been established between MFIs loans and SMEs performance. More studies need to be done focusing on effects of the products provided by microfinance institutions on the financial performance of small and medium enterprises, and the researcher felt that there was need for the study on this area and therefore this study intended to bridge this gap by focusing on the effects of the products provided by microfinance institutions on the financial performance of small and medium enterprises in Machakos town.

General Objective

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

Specific Objectives

(i) To determine the effects of micro savings on financial performance of SMEs.
(ii) To establish the effects of micro credits on financial performance of SMEs.
(iii) To evaluate the effects of micro insurance on financial performance of SMEs.
(iv) To assess the effects of training on financial performance of SMEs.
(v) To determine the overall effects of MFIs' products on financial performance of SMEs

Research Hypotheses

Ho1: Micro savings has no significant effect on financial performance of SMEs.
Ho2: Micro credit has no significant effect on financial performance of SMEs.
Ho3: Micro insurance has no significant effect on financial performance of SMEs.
Ho4: Training has no significant effect of training on financial performance of SMEs.
Ho5: MFIs` products have no significant effect on financial performance of SMEs.

II. Research Methodology

Descriptive research design is concerned with determination of the frequency with which something occurs or the relationship between variables (Cooper and Schindler, 2003). For the purpose of this study,

descriptive research design was employed since the researcher collected information through descriptions and this design is also useful for identifying variables and hypothetical construction. The researcher applied descriptive method to study the relationship between microfinance institutions' products and financial performance of SMEs.

Sampling and data collection

Stratified random sampling was employed, since the various types of businesses being carried by the different SMEs were not homogeneous. The researcher grouped the SMEs into strata, and then randomly selected the SMEs from where the primary data was collected by the questionnaire as a means of data collection. Using Slovin's formula (Ariola et al., 2006), the sample size was determined as 372, at 95% confidence interval.

Data Analysis and Presentation

Both descriptive and inferential statistics were used to analyze data, while correlation and regression were also used to establish the strength of the relationship between microfinance products and financial performance of small and medium enterprises. Statistical Packages for Social Sciences (SPSS) was used by the researcher to facilitate the analysis and interpretation of data.

The following model was used;

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

Where:

FP = Financial Performance, a = Constant, β = Coefficients of variables, X1 = Micro savings

X2 = Micro credit, X3 = Micro insurance, X4 = Training, ε = error term

The study sought to test the following null hypothesis:

Ho: MFIs` products have no significant effect on financial performance of SMEs.

III. Results And Discussion

372 questionnaires were distributed to managers and owners of small and medium enterprises in Machakos town, and out of these, 303 questionnaires were filled and received from the respondents translating to a response rate of 81.45% which statistically represents the targeted population. Majority of the respondents were owners comprising of 78% while the remaining 22% were managers employed in the businesses.

Effects of micro Savings on financial performance of the SMEs

Table 1: Effects of micro savings on financial performance

Statements			**Percentages**			
	Strongly Disagree	Disagree	Neither	Agree	Strongly Agree	**Mean**
The minimum savings allowed by the MFIs affect the financial performance of the business	0	0	30.7	69.3	0	**3.69**
The interest rate on savings offered by the MFIs affect the financial performance of the business	0	0	30.7	59.4	9.9	**3.79**
The various types of saving accounts offered by the MFIs affect the financial performance of the business	0	0	8.9	79.2	11.9	**4.03**
Savings through mobile banking allowed by the MFIs affect the financial performance of the business	0	0	60.4	39.6	0	**3.40**
Micro savings service offered by the MFIs is important in the financial performance of the business	0	0	1	28.7	70.3	**4.69**

Source: Research Data 2014

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

Effects of micro credit on financial performance of the SMEs

Respondents were asked a number of questions on the effects of micro credit on the financial performance of their business, and the results were represented using central tendency and frequency table as follows:

Table 2: Effects of micro credit on financial performance of the SMEs

Micro Credit	**Percentages**					
Statements	Strongly Disagree	Disagree	Neither	Agree	Strongly Agree	**Mean**
The duration to receive loans from the MFIs affect the financial performance of the business	0	0	1	69.3	29.7	**4.29**
Long term loans offered by the MFIs affect the financial performance of the business	0	0	10.9	79.2	9.9	**3.99**
Medium term loans offered by the MFIs affect the financial performance of the business	0	0	10.9	69.3	19.8	**4.09**
Short term loans offered by the MFIs affect the financial performance of the business	0	0	9.9	79.2	10.9	**4.01**
The security required for loans by the MFIs affect the financial performance of the business	0	0	5.0	90.1	5.0	**4.0**
The rate of interest on loans offered by the MFIs affects the financial performance of the business	0	0	5.9	79.2	14.9	**4.13**
The mode of disbursement Of loans from the MFIs affect the financial performance of the business.	0	0	10.9	65.3	23.8	**4.08**
The repayment period of loans offered by the MFIs affect the financial performance of the business	0	1.0	19.8	57.4	21.8	**4.00**
The maximum lending limit offered by the MFIs affect the financial performance of the business	0	5.9	21.8	67.3	5.0	**3.71**

Source: Research Data 2014

From the mean weights obtained, it can be observed that the duration to receive loan from the MFIs had the greatest effect with a mean weight of 4.29 followed by the rate of interest on loans offerd with mean score of 4.13. Hence, the main factors strongly affecting performance were duration of receiving laons and the intrest rates on loans respectively. The maximum lending limit had the least effect on financial performance of SMEs.

Effects of micro insurance on financial performance of the SMEs

Respondents were asked a number of questions to on the effects of micro insurance on financial performance of the SMEs. The results were represented using central tendency and frequency table as follows:

Table 3: Effects of micro insurance on financial performance of the SMEs

Effects of micro insurance	**Percentages**					
Statements	Strongly Disagree	Disagree	Neither	Agree	Strongly Agree	**Mean**
Insurance covers provided by the MFIs affect the financial performance of the business	0	69.3	29.7	1	0	**2.32**
The amount of insurance premiums paid to the MFIs affects the financial performance of the business	0	1	28.2	70.8	0	**3.68**
The time period taken to pay for the risk after occurrence affects the financial performance of the business	0	0	10.9	79.2	9.9	**3.99**

Source: Research Data 2014

It is noted from the above table that, the time period taken to pay for the risk after occurrence had the greatest effect with a mean score of 3.99, followed by the amount of insurance premiums paid by the SMEs to the MFIs with a mean score of 3.68.

Effects of training on financial performance of the SMEs

Respondents were asked a number of questions on the effects of training on the financial performance of their business, and the results were represented using central tendency and frequency table as follows:

Table 4: Effects of training on financial performance of the SMEs

Training	**Percentages**					
Statements	Strongly Disagree	Disagree	Neither	Agree	Strongly Agree	**Mean**
The frequency of training offered by the MFIs affect the financial performance of the	0	0	1	59.4	39.6	**4.39**

business						
Training on management skills by the MFIs affect the financial performance of the business	0	0	1	50.5	48.5	**4.48**
Training on record keeping by the MFIs affects the financial performance of the business	0	0	1	49.7	49.3	**4.48**
Training on the proper use of the loans by the MFIs affects the financial performance of the business	4.3	5.3	4.6	38.6	47.2	**4.19**
Training on the investment areas by the MFIs affects the financial performance of the business	1.7	1.7	14.5	59.7	22.4	**4.0**

Source: Research Data 2014

From the above table, training on management skills and on record keeping had the greatest effects as shown by an equal mean score of 4.48 each, followed by the frequency of the trainings with a mean score of 4.39. The one which had the least effect was training on the investment areas, which had a mean score of 4.0, compared with the others.

Financial performance

Table 5: Financial Performance

Statements	**Percentages**					
	Strongly Disagree	Disagree	Neither	Agree	Strongly Agree	**Mean**
The amount of business capital was more in 2013 than 2012 as a result of using MFIs` products	5.3	1.7	4.6	38.3	50.2	**4.26**
The amount realized by the business for net profits in 2013 was more than 2012 as a result of using MFIs` products	8.9	0.3	8.6	16.5	65.7	**4.30**
The use of micro finance products is the only way to improve the financial performance of the business	2.0	9.2	73.6	10.2	5.0	**3.07**

Source: Research Data 2014

From the above table, the amount realized by the business for the net profits had the highest effects with a mean score of 4.30, followed by the amount of capital in business as a result of using the MFIs` products with a mean of 4.26, and finally with the use of micro finance products as the only way to improve the financial performance of business, with a mean of 3.07

Table 6: Effects of products on financial performance of SMEs

Products	**Percentages**					
Product	Strongly Disagree	Disagree	Neither	Agree	Strongly Agree	**Mean**
Micro-savings	5.9	8.6	8.9	66	10.6	**3.67**
Micro-credit	5	2.6	3.3	22.4	66.7	**4.43**
Micro-insurance	3	14.2	72.9	8.6	1.3	**2.91**
Training	4.6	2.6	5.9	67.3	19.5	**3.94**

Source: Research Data 2014

From the mean scores obtained, the greatest product affecting financial performance is Micro-credit with mean weight of 4.43. This is then followed by training (Mean score=3.94, Micro-credit (Mean score=3.67) and Micro-insurance (Mean score=2.91) respectively.

Table 7: Correlations

		Performance	Micro Savings	Micro Credit	Micro insurance	Training
Performance	Pearson Correlation	1	.645(**)	.674(**)	.437(**)	.666(**)
	Sig. (2-tailed)	.	.000	.000	.000	.000
	N	303	303	303	303	303
Micro Savings	Pearson Correlation	.645(**)	1	.142(*)	.145(*)	.177(**)
	Sig. (2-tailed)	.000	.	.013	.011	.002
	N	303	303	303	303	303
Micro Credit	Pearson Correlation	.674(**)	.142(*)	1	.239(**)	.060
	Sig. (2-tailed)	.000	.013	.	.000	.302

	N	303	303	303	303	303
Micro insurance	Pearson Correlation	.437(**)	.145(*)	.239(**)	1	.147(*)
	Sig. (2-tailed)	.000	.011	.000	.	.010
	N	303	303	303	303	303
Training	Pearson Correlation	.666(**)	.177(**)	.060	.147(*)	1
	Sig. (2-tailed)	.000	.002	.302	.010	.
	N	303	303	303	303	303

** Correlation is significant at the 0.01 level (2-tailed). * Correlation is significant at the 0.05 level (2-tailed).
Source: Research Data 2014

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

Table 8: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.929(a)	.862	.860	.219

a Predictors: (Constant), Training, Micro Credit, Micro Savings, Micro insurance
Source: Research Data 2014

Table 9: ANOVA(b)

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	89.408	4	22.352	466.559	.000(a)
	Residual	14.277	298	.048		
	Total	103.685	302			

a Predictors: (Constant), Training, Micro Credit, Micro Savings, Micro insurance
b Dependent Variable: Performance

Source: Research Data 2014

Table 10: Coefficients(a)

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	-.071	.091		-.781	.435
	Micro Savings	.228	.013	.381	17.227	.000
	Micro Credit	.249	.013	.438	19.684	.000
	Micro insurance	.273	.021	.292	12.987	.000
	Training	.284	.015	.427	19.379	.000

a Dependent Variable: Performance
Source: Research Data 2014

From table 8 above, it is revealed that there is a strong relationship between the observed financial performance of SMEs and the optimal linear combination of the independent variables (Micro savings, micro credit, micro insurance and training as shown in the Multiple R is 0.929. As indicated, the R- Square value 0.862 and the adjusted R-Square value 0.860, 86.2% of the variance in financial performance of SMEs in Machakos town is explained by the selected independent variables while the remainder (13.8%) can be explained by other factors not included in this model. Table 9 above shows the regression equation's P < 0.01, implying that it was effective in measuring the effect of the products on financial performance of SMEs.

From table 10 above, column B of the unstandardized coefficients, the coefficients of the independent variables including the predictor variables are shown in the regression equation below:

Financial performance = -0.071 + 0.228 Micro Savings + 0.249 Micro Credit +0.273 Micro Insurance + 0.284 Training

From the significance column of the provided table, at 1% level of significance, it can observed that micro savings, micro credit, micro insurance and training are the main variables that explain the variance in financial performance of SMEs. From the above regression equation, a unit change increase in micro savings

leads to a 22.8% increase in financial performance, a unit increase in micro credit leads to 24.9% increase in financial performance, a unit increase in micro insurance leads to a 27.3% increase in financial performance and a unit increase in training leads to a 28.4% increase in financial performance.

Summary of Findings, Conclusion and Recommendations

Effects of Micro Savings on Financial Performance of SMEs

The first objective sought to determine the effects of micro savings on financial performance of SMEs. The results showed that at 1% level of significance, Micro Savings played a significant role in determining financial performance of SMEs in Machakos town ($r = 0.645$, $P<0.01$).

The regression analysis findings indicated a positive relationship between micro savings and financial performance. The study, also, found a positive consistent correlation between micro savings and financial performance (0.645). The study therefore rejected the null hypothesis that micro savings has no significant effect on financial performance of SMEs.

The findings are supported by Kemei (2011) who noted that savings had a strong relationship with the financial performance of SMEs. Cooper (2012) also noted that savings contributed to the growth of SMEs.

Effects of Micro Credit on Financial Performance of SMEs

The second objective sought to determine the effects of micro Credit on financial performance of SMEs. The results showed that at 1% level of significance, Micro Credit played a significant role in determining financial performance of SMEs in Machakos town($r=0.674$, $P < 0.01$). The regression analysis findings indicated a positive relationship between micro Credit and financial performance. The study, also, found a positive consistent correlation between micro Credit and financial performance (0.674). The study therefore rejected the null hypothesis that Micro credit has no significant effect on financial performance of SMEs.

The findings in the study agree with Cooper (2012), in his study on the Impact of Microfinance Services on the Growth of Small and Medium Enterprises, found out that one of the services provided by MFIs is credit which had great influence on SMEs` growth.

Effects of Micro Insurance on Financial Performance of SMEs

The Third objective sought to determine the effects of micro Insurance on financial performance of SMEs. From the results, it was observed that at 1% level of significance, micro insurance played some role in determining financial performance of SMEs in Machakos town ($r=0.437$, $P < 0.01$). From the regression analysis, the hypothesis that Micro insurance has no significant effect on financial performance of SMEs was tested at 1% significant level. It was observed that, Micro insurance do play a significant role in determining financial performance of SMEs; thus, the null hypothesis may be rejected. This concurs with Johnson (2000), also supported the inclusion of micro insurance to increase the performance of small businesses.

Effects of Training on Financial Performance of SMEs

The fourth objective sought to determine the effects of Training on financial performance of SMEs. The results showed that at 1% level of significance, training played a significant role in determining financial performance of SMEs in Machakos town ($r=0.666$, $P < 0.01$). The regression analysis found a positive relationship between SMEs financial performance and the MFIs` training. The study found a positive and good association between MFIs` training and SMEs financial performance (0.666) with an overall correlation coefficient. The study therefore rejected the null hypothesis "Training has no significant effect on financial performance of SMEs"

The findings are supported by Chi & Lin (2008) in their study on whether training facilitates SME's performance; found out that it greatly facilitated the SME's performance.

IV. Conclusion And Recommendations

The product with most effect on the SMEs` financial performance is micro credit, where the duration to receive the loans was the greatest factor to consider, and the interest on loans changed is the immediate factor that is key. Loans categorized as medium loans, were considered appropriate to the SMEs as compared to other types of loans offered by the MFIs. Micro credit product was followed by training, where training on management skills and record keeping are key, followed by the frequency of the training. Micro insurance was found to have the least effect on financial performance, of the products provided by the MFIs to SMEs, where the time taken to pay for the risk and the amount of premium paid were the most important factors to consider. The researcher recommended that business and financial training should be provided by MFIs on a regular basis and most cases should be tailored toward the training needs of the SMEs. The growth of SMEs in Machakos town is slow despite of the existence of MFIs in the area, with the many products they offer. The concern

therefore is on what factors influence the growth of SMEs in the town? This is an area that needs further detailed research.

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