

DETERMINANTS OF PERFORMANCE OF MICROFINANCE INSTITUTIONS IN NYAHURURU SUB-COUNTY, KENYA

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Abstract: Increased competition and associated deterioration of lending portfolios are growing concerns that face micro finance institutions (MFIs) in Kenya. Some micro finance experts have expressed frustration regarding the subsequent upward trend in defaults and over indebtedness that are inhibiting growth of the MFIs. The study adopted a descriptive research design and a sample of 39 respondents was taken out of the target population of 62 respondents using stratified random sampling technique. Questionnaire was used to obtain data. Descriptive and inferential data analysis was done. All the null hypothesis were rejected and alternative hypotheses accepted. The study revealed that customers are the main players in the success of MFIs in Kenya. Regression results showed that customer orientation was significant with F-value=21.65, at p-value=0.000<0.05, physical facilities with F-value=8.264, p-value=0.000<0.05, technology adoption with F-value=9.035, p-value =0.000<0.05 and legal framework with F-value=33.842, p-value =0.000<0.05. Overall, all the variables investigated had a statistically significant influence on performance of MFIs in the study area. However, there are other factors that explain the variability of the financial performance in small businesses in Kenya that were not included in the model.

Keywords: (Customer orientation, Physical facilities, Technology, Legal framework, performance).

I. INTRODUCTION

A microfinance institution is a financial institution that is involved in provision of small-scale financial services to low income clientele who have no access to conventional banks (Kagwiria & Wachira, 2016). Poverty has highly contributed to the 2 billion unbanked populations where we have 767 million individuals worldwide living below US\$1.90 per person per day (World Bank, 2016). Internationally, 59% of adults did cite lack of adequate funds as the major reason to their financial exclusion. This is a clear indication that financial services are not yet affordable or designed to fit the low-income earners. Additionally, poor individuals are ignored by commercial banks and are regarded as “unbankables” (World Bank, 2016). However, Professor Muhammad Yunus, The Nobel Prize winner in 2006, using Grameen bank model attested that poor people are viable customers. Since then the micro finance market has grown at a high rate and has enlarged its portfolio of financial services beyond pure microcredit (Schmidt, 2008). In Africa 350 million adults are financially excluded with significant opportunities to expand affordability, accessibility and usage of formal financial services (Villasenor, West, & Lewis, 2015).

Since about a decade ago, microfinance has received a focused attention from the United Nations, including the declaration of the year of microfinance in 2005, and the associated studies and publications, the strengthening of the activities of its specialized fund for small scale investment (UNCDF) and more recently, the designation of the UN Secretary General’s Special Advocate for Inclusive Finance (Anderson & Baland, 2002). The UN’s intense interest reflects the fact that, despite the challenges of microfinance, it has emerged as an important tool for poverty reduction in

African. Notwithstanding the recent financial and economic crises that adversely affected many African economies, microfinance grew on the continent at a remarkable pace even at the height of the crisis in 2008. At the end of 2008, Microfinance Institutions in SSA reported reaching 16.5 million depositors and 6.5 million borrowers. Moreover, even when the region witnessed a slowed growth in borrowers in 2008, there was a continued and strengthened uptake for depositors, as their growth rate increased by 10 percent to reach 40 percent, which is more than for any other region (Anderson & Baland, 2002).

According to Afraine (2002) Microfinance in Africa is developing at all three levels of the financial system (micro, meso, and macro). At the micro level (financial services providers), there are many stakeholders and growing interest from banks and private investors. Microfinance institutions (MFIs) play a predominant role, with the credit unions still dominant in terms of membership, although the bulk of savings is mobilized through the banks. At the meso level (support services suppliers), services such as training or auditing are available and some associations are playing an important role of coordinating MFIs' activities. At the macro level (policy, regulatory framework, and supervision), countries are increasingly shifting to a conducive paradigm of market-based policies, while also putting in place regulatory and supervisory frameworks (Afrane, 2015).

In India, the formal sector Banking Institutions have been serving only the needs of the commercial sector and providing loans for middle- and upper-income groups (Kennedy, 2013). Similarly, for housing, the HFI's have generally not evolved a lending product to serve the needs of the Very LIG primarily because of the perceived risks of lending to this sector. The following risks are generally perceived by the formal sector financial institutions: Credit Risk, High transaction and service cost, Absence of land tenure for financing housing, irregular flow of income due to seasonality, Lack of tangible proof for assessment of income and Unacceptable collaterals such as crops, utensils and jewelry (UNEP, 2015).

In Kenya, increased competition and the associated deterioration of lending portfolios of micro finance institutions is a growing concern and some micro finance experts have expressed frustration regarding the upward trend in defaults and over indebtedness hence inhibiting growth of micro finance institutions (Rosenberg, 2010). A study by Maina (2011) on factors influencing the growth of micro finance institutions in Nyeri Central District, Nyeri County Kenya showed that low annual turnover, low number of savers, high number of defaulters, outdated technology, poor marketing, inability to improve on products and services and centralized management were factors that influenced growth negatively. The main question to be addressed by this study was why some microfinance institution outperforms others in generally similar market environment. The study therefore intended to carry out an in-depth study on how customer orientation, physical facilities, uses of technology and legal framework influence performance of micro finance institutions in Nyahururu Sub-County, Kenya. The study was guided by three null hypotheses;

H₀₁: Customer orientation does not have a statistically significant influence on performance of micro finance organizations in Nyahururu Sub-County, Kenya

H₀₂: Physical facilities have no statistically significant influence on performance of micro finance organizations in Nyahururu Sub-County, Kenya

H₀₃: Use of technology does not have statistically significant influence on performance of micro finance organization in Nyahururu Sub-County, Kenya

H₀₄: Legal framework does not have a statistically significant influence on performance of micro finance organizations in Nyahururu Sub-County, Kenya.

II. THEORETICAL UNDERPINING

The Grameen Bank (2000) identified fourteen different microfinance models of which this research focused on three; Micro credit theory, Rotating Savings and Credit Association (ROSCAs), the Grameen Bank, Technology adoption model and the Village Banking models.

The psychological component of the micro credit theory - known as social consciousness-Driven capitalism - has been advanced by the most ardent promoter of micro finance (Yunus, 2008). His theory argues that a species of profit-making private venture that cares about the welfare of its customers can be conceived. In other words, it is possible to develop capitalist enterprises that maximize private profits subject to the fair interests of their customers (Elahi, Khandakar, Danopoulos & Constantine, 2004).

The rationale of the theory is straightforward. Although altruism is not totally absent, Capitalism is founded mainly on the premise that human beings are selfish by nature. Accordingly, individuals interested in businesses are naturally motivated by the principle of profit-maximization, with little consideration for the interests of their clients. This premise is too limited to be a general model for capitalism, however, because it excludes individuals who are concerned about the welfare of their fellow human beings. A more generalized principle would assume that an entrepreneur maximizes a bundle consisting of financial return or profit and social return. This assumption creates three groups of entrepreneurs (Elahi, 2013). The first group consists of traditional capitalists who mainly maximize financial returns or profits. The second group consists of philanthropic organizations (like traditional micro credit NGOs) and public credit agencies that mainly maximize social returns.

The third group consists of entrepreneurs who combine both rates in making their investment decisions under the additional constraint that financial return cannot be negative. This group includes the microfinance enterprisers who are to be treated as socially concerned people, and microfinance, which is to be treated as a social consciousness-driven capitalistic enterprise. Microfinance theoreticians have advanced two theories regarding their aims-an economic and a psychological. The economic theory treats microfinance institutions (MFIs) as infant industries, while the psychological theory differentiates microfinance entrepreneurs from traditional money lenders by portraying them as "social consciousness driven people."

According to Remenyi (2010), the gist of the economic argument is that success in any business venture, including MFIs, is determined by the entrepreneurs' ability to deliver appropriate services and profitably. However, studies conducted in different parts of the world show that there are no successful MFIs by this definition. At best, some MFIs cover their operating costs while some of the better known among them are able to cover in part the subsidized cost of capital employed. This situation suggests that the MFIs will not become financially viable in the long run. One solution to this problem is to treat MFIs as infant industries, so that micro-lending businesses can be subsidized during their initial stages of operation. This subsidization would be beneficial to both the economy and society because this will help micro lenders realize economies of scale and the productivity fillip that comes with profitability. This subsidization is all brought about by the proper legislation and policies formulated to protect the micro finance institution to grow and expand in a conducive business environment in respective states, since the logic goes as follows; over time, as clients of MFIs, micro entrepreneurs will establish their economic contracts with banks, retailers, government employees, and suppliers of production inputs, this would improve their skills dealing with money management, contractual obligations, and resource management they will also have improved on better skills and facilities to handle big businesses transaction and be able to face competition with the major banks, that are financial institutions. These skills should reduce the cost of transaction, disseminate information, and increase the micro entrepreneurs' ability to assess effectively available information to make sound business decisions. In this respect, society benefits from what is, in effect, a productive process leading to the creation of public goods as spin-offs from the growth of microfinance. To the extent that these public goods have value, they are a legitimate basis on which to provide subsidies to MFIs while the transition to widespread outreach to poor households is ongoing (Remenyi, 2010).

In the context of this study, the micro credit theory was used to gain insights into performance of MFIs as profit-making enterprises against a background of a fair concern for the interests of customers and to probe into whether this is sustainable. The model of micro credit is driven by a merge of interest between capital-driven investment and social consciousness. This study investigated how the apparently conflict operational ideologies have affected performance of MFIs in Nyahururu.

A Rotating savings and credit association (ROSCA) is a group of individuals who agree to meet for a defined period in order to save and borrow together, a form of combined peer – peer banking and peer-peer lending. Rotating Savings and Credit Association is formed when a group of people come together to make regular cyclical contributions to a common fund, which is then given as a lump sum to one member of the group in each cycle (Grameen Bank, 2000). According to Harper (2002), this model is a very common form of savings and credit. He states that the members of the group are usually neighbours and friends, and the groups provides an opportunity for social interaction and are very popular with women. They are also called merry-grounds or Self-Help Groups (Fisher & Sriram, 2002).

According to Hugh (2007) every transaction is seen by every member during the meetings. Since no money has to be retained inside the group, no records have to be kept. These characteristics make the system a model of transparency and simplicity that is well adapted to communities with low levels of literacy and weak systems for protecting collective

property rights. The system further reduces the risk to members because it is time limited typically lasting no more than 6 months. Each member receives at least once the amount collected. This reduces the size of the loss, should someone take funds early and not pay back. In this study, ROSCA model presents the business case of MFI. The study sought to determine whether riding on ROSCA model has resulted in to better customer focus at MFI or it has weakened it.

Village banks are community-managed credit and savings associations established by NGOs to provide access to financial services, build community self-help groups, and help members accumulate savings (Holt, 1994). They have been in existence since the mid-1980s. They usually have 25 to 50 members who are low-income individuals seeking to improve their lives through self-employment activities. These members run the bank, elect their own officers, establish their own by-laws, distribute loans to individuals and collect payments and services (Grameen Bank, 2000). The loans are backed by moral collateral; the promise that the group stands behind each loan (Global Development Research Centre, 2013).

The sponsoring MFI lends loan capital to the village bank, who in turn lend to the members. All members sign a loan agreement with the village bank to offer a collective guarantee. Members are usually requested to save twenty percent of the loan amount per cycle (Ledgerwood, 1999). Members' savings are tied to loan amounts and are used to finance new loans or collective income generating activities and so they stay within the village bank. No interest is paid on savings but members receive a share of profits from the village bank's re-lending activities. Many village banks target women predominantly, as according to Holt (1994) "the model anticipates that female participation in village banks could enhance social status and intra household bargaining power". MFI are institutions that are driven by community focus through village banking model. This study sought to determine the sustainability of this approach and how it implicates profitability on MFIs in the study area. It sought to determine the role of customer focus on performance of MFI in addition to operations based on village banking model.

This study was based on the Technology Adoption Model (TAM) whose main proponent is Fred Davis (1989) which is a model of user acceptance of information systems technology and is an extension on the theory of reasoned action. The model is supporting the study individual's acceptance of technology by taking into account, both the perceived ease of use and the usefulness of the technology (IGI Global, 2017). Adopting new technologies enable financial organizations to enhance their service abilities. Technological developments have removed repetitive, time consuming tasks, reduced human error and extended access to banking related facilities. Technology also provides customer information that it would be much more expensive to provide on a person-to-person basis (Curry & Penman, 2004).

Technological innovation is the key variable and the means of differentiation between organizations implies that organizations could increase their performance by employing new technologies Speakman (2002). However, despite the presence of technology, adoption of the technology is important. Ernest Burkman's (1987) user-oriented development approach proffers that favored adoption and diffusion of technology generally consists of 5 adopter-focused steps; Potential adopter identification, Measurement of their relevant perceptions, User (adopter)-friendly product design and development, Informing the potential user (adopter) of the product and Support after adoption. This study sought to establish the extent to which adoption and use of technology has influenced the performance of microfinance institutions.

III. RESEARCH METHODOLOGY

The study applied a descriptive research design with a sample of 41 respondents who comprised of top managers, middle level managers and lower cadre employees. To identify the respondents of the study a stratified random sampling technique with allocation of sample proportional to size was used. A questionnaire was used to collect data from the respondents. A self-administration method was used to collect the data where the respondents filled the questionnaire and the questionnaire was picked immediately. Thirty-seven questionnaires were returned and this represented 90.24% response rate, which was deemed to be high enough for the purpose of data analysis. Inferential data analysis method was used to analyze the data. Tools for inferential data analysis used were regression, correlation and hypothesis testing.

IV. RESULTS AND DISCUSSION

Regression analysis was carried out to determine the relationship between independent variables and performance of microfinance organizations. The R-value for customer orientation was 0.622. and the adjusted R square was 0.3869 implying that 38.69% of the variations in the performance of MFOs in Nyahururu Sub County can be attributed to customer orientation. The remaining 61.31% of the variations in the performance of MFOs can be attributed to other factors other than customer orientation. The R value for physical facilities was 0.472, R square was 0.223 and the adjusted R square was 0.222 which implied that 22.2% of the variations in the performance of Micro-Finance Organizations was

influenced by physical facilities while the remaining 77.8% of the variations in performance of MFOs can be attributed to other factors other than physical facilities.

The R-value for technology adoption was 0.574, R square was 0.330, the adjusted R square was 0.33 which implied that 33.0% of the variations in Performance of MFOs was influenced by adoption of technology. The remaining 67% can be attributed to other factors other than adoption of technology. R-value for legal framework was 0.557, R square value was 0.310 while the adjusted R square was 0.309 which implied that 30.9% variation in Performance of MFOs could be attributed to the legal framework under which the MFOs operate. Since there are other factors that influence the performance of MFOs other than the legal framework, the remaining 69.1 of the variations in performance of MFOs can be attributed to those factors.

The multiple regression analysis results showed that when the four independent variables are put together, they explained 69.2% of the variation in the performance of microfinance organizations. This shows that the combined influence of the four independent variables is more than the influence of individual independent variables. However, the four combined independent variables cannot explain wholly the variation of performance of microfinance organizations. This means this difference of 30.8% in variation of performance of microfinance organizations can be explained by other factors that were not in the model.

The analysis of Variance (ANOVA) for customer orientation and performance of MFO's indicates that the model fit is appropriate for this data since F value is 21.650, p values was 0.000 which is less than 0.05. Therefore, the model is significant in predicting the performance of MFOs. The study therefore rejects the null hypothesis that there is no statistically significant influence of customer orientation on performance of MFOs. The conclusion therefore is that, customer orientation has statistically significant influence on the performance of MFOs.

The analysis of Variance (ANOVA) for physical facilities and performance of MFO's indicates that the model fit was appropriate for this data since $p=0.000$ which is less than 0.05 and the F value was 8.264 significant at 0.000. Therefore, the study rejected the null hypothesis that physical facilities have no statistically significant influence on performance of microfinance organizations and concludes that indeed physical facilities have a statistically significant influence on the performance of MFOs in Nyahururu sub-county, Kenya.

The analysis of variance for technology adoption and performance of MFO's reveals that at significance level of 0.05 the model fit is also appropriate for this data since the p value does not exceed the threshold of 0.05, F value was 9.035 that was significant at 0.000 indicating a significant positive linear relationship between Technology Adoption and Performance of MFOs in Nyahururu Sub-County. Therefore, the study rejected the null hypothesis that adoption of technology has no statistically significant influence on performance of MFOs. The study concludes that adoption of technology has statistically significant influence on the performance of MFOs in Nyahururu Sub-county, Kenya.

The analysis of variance for legal framework and performance of MFO's reveals that at significance level of 0.05 the model fit is also appropriate for this data since the p value does not exceed the threshold of 0.05, F value was 33.382 that was significant at 0.000 indicating a significant positive linear relationship between legal framework and performance of MFOs in Nyahururu Sub-County. The study therefore rejected the null hypothesis that legal framework has no statistically significant influence on the performance of MFOs and concluded that indeed legal framework has a statistically significant influence on the performance of MFOs in Nyahururu sub-county, Kenya.

Analysis of regression model coefficients was also carried out and the results were as follows; for customer orientation, there is a positive beta coefficient of 0.204 as indicated in the coefficient's matrix with a p-value= 0.00 which is less than 0.05 and a constant of -0.475. Hence, both the constant and customer orientation contributes significantly to the model. The model can provide information needed to predict performance of MFOs from customer orientation. The regression equation is presented as $Y = -0.475 + 0.204X_1$ which implies that a unit change in customer orientation leads to an increase of positive 0.204 units in performance of microfinance Organizations and that in the absence of customer orientation, the performance will be negative 0.475.

For physical facilities, there is a positive beta coefficient of 0.186 as indicated in the coefficient's matrix with a p-value= 0.00 and a constant of 0.436 with a p-value of 0.000 which is less than 0.05. Hence, both the constant and physical facilities contribute significantly to the model. The model can provide information needed to predict performance of MFOs from physical facilities. The bivariate regression equation is

$Y = 0.436 + 0.186X_2$. The regression equation implies that a unit change in physical Facilities leads to an increase of positive 0.186 units in performance of microfinance Organizations and that in the absence of physical, the performance will be positive 0.436.

For technology adoption, there is a positive beta coefficient of 0.753 as indicated in the coefficient's matrix with a p-value= 0.00 and a constant of 0.117 with a p-value of 0.000 which is less than 0.05. Hence, both the constant and adoption of technology contribute significantly to the model. The model can provide information needed to predict performance of MFOs from adoption of technology. The regression equation is $Y = 0.117 + 0.753X_2$. The regression equation implies that a unit change in Technology Adoption leads to an increase of positive 0.753 units in performance of Microfinance Organizations and that in the absence of technology adoption, the performance will be positive 0.117.

For legal framework, the constant is 0.594 while the beta coefficient is 0.693 with a p-value= 0.00. Hence, both the constant and legal framework contributes significantly to the model. The model can provide information needed to predict performance of MFOs from legal framework. The constant of 0.594 implies that when legal framework is nonexistent, the performance of MFOs will still be positive 0.594. The regression equation can be expressed in the form $Y = 0.594 + 0.693X_4$ which implies that a unit change in legal framework leads to a positive change of 0.693 in performance of MFOs.

V. CONCLUSION

Customers are the main players in the success of any micro financial institution in Kenya. Therefore, the customer needs should be put into consideration, their complaints heard and responded to appropriately since they determine the performance and success of the MFIs. Concerning the, physical facilities, the existence, accessibility and comfortability of the physical facilities such as the building, chairs and resting places greatly determines the performance of the micro financial institutions. Most Micro financial institutions in Nyahururu Sub County had company website and Facebook page. However, they had not widely applied mobile banking, use of ATM in their banking system Majority of the MFI in Nyahururu Sub County had not adhered to the rules and regulations governing banking in Kenya. However, some rules and regulations are not favorable and should be reconsidered. Rules are significant to the performance of MFIs since they have a general positive effect.

VI. RECOMMENDATIONS

Based on the conclusions from the findings, the study made the following recommendations.

The MFIs need to put the customer needs into consideration when designing products. The MFIs need to strengthen the customer service delivery to enhance performance. The products should satisfy the needs of the customers and seek to improve performance of the MFIs. MFIs should also increase the avenues and expand channels through which customers raise their complaints.

The physical facilities should be designed to serve the needs and conditions of every customers and employees. The rooms need to be accessible and the MFI should be in good and conducive environment. The MFIs should expand and increase accessibility to their banking halls. They should also improve both the décor and illumination of the banking halls. MFIs should also improve the standards of banking halls to ensure that they meet the requirements of the CBK. They should also move the banking halls away from areas that are free of noise pollution.

The MFIs need to use the technology to the greater extent. They need to incorporate mobile and internet banking and even develop use of ATM to enhance performance. They should enhance innovative use of technology through use of internet banking and through use of social media such as facebook. They should also enhance use of website as platform for banking.

MFIs should develop favorable policies in order to enhance their performance. Rules and regulations that govern MFIs should be relaxed. The government and the stakeholders need to review the rules and regulations governing the banking in the MFIs in Kenya to make them friendlier. The regulations need to be bearable and provide conducive environment for the operation of the micro financial institutions. All MFIs should also ensure they meet all the legal requirements of CBK.

VII. SUGGESTIONS FOR FURTHER STUDIES

The study recommends the following areas for further studies

1. The relationship between physical business premises and customer satisfaction for MFIs in Nyahururu
2. The role of legal framework on technology innovativeness of MFIs in Nyahururu
3. The relationship between business premises and market orientation of MFIs in Nyahururu

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