EFFECT OF FIRM CHARACTERISTICS ON PERFORMANCE OF THE MICROFINANCE SECTOR IN NAKURU, KENYA

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A RESEARCH PROJECT SUBMITTED TO THE GRADUATE SCHOOL IN PARTIAL FULFILLMENTOF THE REQUIREMENTSFOR THE AWARD OF THE DEGREE OF MASTERSIN BUSINESS ADMINISTRATION OF EGERTON UNIVERSITY

EGERTON UNIVERSITY

OCTOBER 2014

DECLARATION AND APPROVAL

Declaration

This research project is my original work and has not been presented for examination in any other institution.

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Approval

The research project has been submitted with our approval as university supervisors.

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DEDICATION

Thanking the Almighty God for this achievement, I humbly wish to dedicate my research work to my family for the sacrifice, moral support and understanding, without which I would not have come this far. Special dedication to my wife Christine who gives me a reason to work hard in everyday life. God bless you all.

ACKNOWLEDGEMENT

ABSTRACT

The development of entrepreneurship is an important economic development but is challenged by lack of capital. Microfinances are set up with the main objective of financing small enterprises but still they are not capable to meet the capital needs of the businesses. In spite of the importance of this sector, the provision and delivery of financial services by these firms has been below expectation. Literature suggests that firm characteristics determine performance of microfinances. However it is not clear to what extent these firm characteristics affect the performance of MFIs in Kenya. The aim of this study was to investigate the effect of firm characteristics on the performance of microfinance sector in Kenya. The study adopted correlational research design. A census study of the 48 institutions offering microfinance services and registered with Association of Microfinance Institution (AMFI) operating in Nakuru town was done. Primary data was collected using questionnaires. This was supplemented with secondary data. Data on firm characteristics and organizational performance was summarized using descriptive statistics. The relationship between firm characteristics and performance of MFIs was examined using Pearson's product moment correlation coefficient. The effect of firm characteristics on performance of MFIs was determined by multiple regression analysis. The findings revealed that firm characteristics have a significant positive effect on the performance of MFIs. Structure related characteristics had the greatest effect; market related had moderate effect while capital related had the least effect on performance of MFIs. Therefore to improve on organizational performance of MFIs, it was recommended that practitioners need to address firm characteristics. The study also suggests areas of further research.

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ABBREVIATIONS

AMFI - Association of Microfinance Institutions

ANOVA - Analysis of variance

AROA - Average Return on Asset

CBD - Central Business District

CEO - Chief executive officer

DECSI - Dedebit Credit and Saving Institution

DTMF - Deposit Taking Microfinance

EPS - Earnings per Share

G.O.K - Government of Kenya

MFI - Microfinance Institutions

MSE - Micro and Small Enterprises

NGO - Nongovernmental Organizations

R&D - Research and Development

ROA - Return on Asset

ROE - Return on Equity

SME - Small and Medium Enterprise

USD - United States Dollar

WACC - Weighted Average Cost of Capital

CHAPTER ONE

INTRODUCTION

1.1   Background of the Study

The growing global concern about persistent stagnation and decline in economic growth, accompanied by chronic unemployment, poverty and its resultant social problem have led to increased search for strategies which can stimulate economic growth. One strategy that has been growing in importance is entrepreneurship development. Both developed and developing countries have therefore focused on this strategy. In almost all economies, small businesses are critical for sustained growth. They have been the means through which accelerated economic growth and rapid industrialization have been achieved (Arinaitwe, 2002).

Kenya has thus created conditions for private sector growth but is still held back by an inadequate financial system (Lafourcade et al., 2005). Various analyses (Sauser, 2005; Harris & Gibson, 2006) have identified the challenges of the sector as lack of capital, inhibiting enabling environment and poor non-financial promotional programs. This means that it is difficult for the poor to elevate out of poverty due to lack of finance for their productive activities. About 60% of the population are poor and mostly out of the scope of formal banking services (Omino, 2005). The formal banking sector in Kenya over the years has regarded the informal sector as risky and not commercially viable. Therefore, new, innovative, and pro-poor modes of financing low-income households based on sound operating principles have been developed by the microfinance sector.

1.1.1   Firm Characteristics

Various business settings have specific and unique attributes that make them distinguishing. According to Golan et al., (2003) firm's resources and objectives summarized as firm characteristics, influence success and failures associated to performance of organizations. Firm characteristics refer to the enterprise and related variables which play an important role on the business success. These include Structure, Market and Capital-related variables.

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Structure-related variables include firm size, leverage, ownership dispersion, firm age, debt, corporate strategy. These variables are thought to be fairly stable and constant over time (Wallace et al., 2004). Market-related variables include industry type, environmental uncertainty, market environment, production technology. These variables could be either time-period specific or relatively stable over time. They may be under or out of the control of the firm (Wallace et al., 2004). Leading firms operating in a particular industry could produce a bandwagon effect on the level of performance adopted by other firms working in the same industry. Capital-related variables include liquidity, profit margin, return on equity, capital intensity. Firms enjoying a sound financial position, more specifically higher liquidity are more inclined to better performance (Wallace et al., 2004).

1.1.2   Organizational Performance

Daft (1995) defined performance as the evaluation of achievement of the company target. Organizational performance refers to the firm's success in the market, which may have different outcomes. Organizational performance is a focal phenomenon in business studies. However, it is also a complex and multidimensional phenomenon. It can be characterized as the firm's ability to create acceptable outcomes and actions. Success, in general, relates to the achievement of goals and objectives in whatever sector of human life. In business life, success is a key term in the field of management, although it is not always explicitly stated (Papadopoulos & Giama, 2007).

However, there is no universally accepted definition of success, and business success has been interpreted in many ways (Foley & Green 1989).There are at least two important dimensions of success that is financial vs. other success and short- vs. long-term success. Hence, success can have different forms, e.g. survival, profit; return on investment, sales growth, number of employees, happiness, reputation, and so on.

1.1.3   Microfinance

To meet unsatisfied demand for financial services, a variety of microfinance institutions have emerged over time in Africa. Some of them concentrate only on providing credit, others are engaged in providing both deposit and credit facilities, and some are involved only in deposit collection (G.O.K, 2006). In Sub-Saharan Africa microfinance sector include a broad range of diverse and geographically dispersed

institutions that offer financial services to low-income clients that is, nongovernmental organizations (NGOs), non-bank financial institutions, cooperatives, rural banks, savings and postal financial institutions, and an increasing number of commercial banks (Lafourcade, et al., 2005). According to Omino (2005) microfinance is the provision of financial services to the low-income households and micro and small enterprises (MSEs) which provide an enormous potential to support the economic activities of the poor and thus contribute to poverty alleviation. He further says widespread experiences and research have shown the importance of savings and credit facilities for the poor and MSEs. This puts emphasis on the sound development of microfinances as critical ingredients for investment, employment and economic growth.

Microfinances play a critical role in the economic development of many developing countries. They offer loans and/or technical assistance in business development to low-income community (Hartungi, 2007). They have a variety of products including micro loans, savings and other deposit products, remittances and transfers, payment services, insurance, and any other financial product or service that a commercial bank may not offer to low-income clients in the banking system (Hoque & Chisty, 2011).

Since its birth in the 1970s, microfinance has endeavored to develop sustainable enterprises and its innovations have been replicated from country to country, each time with renewed enthusiasm and innovation leading to international best practices that have benefited and guided the practice of microfinance (Kiweu, 2009; Stauffenberg, 2001; Rhyne, 2001; Labie, 2001). Given the ongoing developments in microfinance, there is considerable interest for many MFIs in Africa to keep pace with the changing landscape in the industry. However, the microfinance industry in most African countries remains largely underdeveloped (Gupta, 2008). African MFIs have continuously faced many challenges including lack of proper regulatory environment and lack of funds. Despite the series of financial sector reforms that the African countries have undertaken since the 1980s, financial systems still exhibit substantial degrees of inefficiencies in their savings mobilization and allocation of resources into productive activities (Senbet & Otchere, 2006). Operating and financial costs are high, and on average, revenues remain lower than in other global regions (Manroth, 2001).

It is therefore important to find cost-effective ways of improving standards while at the same time minimizing restrictions and encouraging competence. Technological innovations, product refinements, and ongoing efforts to strengthen the capacity of African MFIs are needed to reduce costs, increase outreach, and boost overall profitability (Lafourcade, et al., 2005). Consequently, the MFIs should develop viable financial products relevant to the target markets.

According to Omino (2005), different types of financial services providers for poor people have emerged that is non-government organizations (NGOs); cooperatives; community-based development institutions like self-help groups and credit unions; commercial and state banks; insurance and credit card companies; telecommunications and wire services; post offices; and other points of sale - offering new possibilities. In the past, MFIs established using either an NGO or a savings and credit co-operative societies framework have been important sources of credit for a large number of low income households and MSEs in the rural and urban areas of Kenya. The microfinance sector has, however, operated without an appropriate policy and legal framework. There is therefore need to focus more on these institutions to enhance their effectiveness in the provision of savings, credit and other financial services to the poor and MSEs (Omino, 2005).

Over 100 organizations, including about 50 NGOs, practice micro finance business in Kenya. About 20 of the NGOs practice pure micro financing, while the rest practice micro financing alongside social welfare activities. Many microfinance NGOs have successfully replicated the Grameen Bank method of delivering financial services to the low-income households and MSEs (Omino, 2005). The Government of Kenya recognizes that greater access to, and sustainable flow of financial services, particularly credit, to the low-income households and MSEs is critical to poverty alleviation. Therefore, an appropriate policy, legal and regulatory framework to promote a viable and sustainable system of microfinance in the country has been developed through the Deposit Taking Micro Finance which has since been enacted. In enacting the Bill into law, the Government had consulted with stakeholders to get their views on the best way to create the required enabling environment for the microfinance sub-sector. Despite this important contribution, only 10.4% of the MSEs

receive financial services (Omino, 2005). The greatest challenge faced by MFIs is to meet the capital requirements of the MSEs and also to reach all entrepreneurs.

1.2   Statement of the Problem

Microfinances usually play an important role in financing small and medium enterprises to alleviate poverty. In as much as microfinance is seen as a possible solution to the financial problems of small and micro businesses, the capital needs of the businesses have not been adequately met suggesting there are factors affecting performance of microfinances. Strategic management literature further suggests that firm characteristics affect performance of organizations (Nugroho & Miles, 2009).Although a number of researches (Aklilu, 2002; Borchgrevink et al., 2005) have been done on factors that contribute to performance of microfinances, little has been done to empirically determine the effect of firm characteristics on the performance of institutions offering microfinance services particularly in Kenya. Microfinances however, generally face a myriad of challenges ranging from product failure, default and high drop-out rates which have a direct bearing on the performance. Wright (2001), notes that there is compelling evidence to support the contention that a significant majority entrepreneurship failure occurs because microfinance services are inadequate to meet the needs of the very clients they are claiming to serve. Theoretically there is a link between firm characteristics and organizational performance. This study therefore sought to empirically examine the effect of firm characteristics on the performance of the microfinance sector by surveying microfinance industry in Nakuru municipality.

1.3   Objectives of the Study

The purpose of the study was to examine the effect of firm characteristics on the performance of microfinance sector in Nakuru. The specific objectives of the study were to:

  i.   Determine the effect of structure-related firm characteristics on performance of the microfinances

  ii.   Determine the effect of market-related firm characteristics on performance of the microfinances

iii. Determine the effect of capital-related firm characteristics on performance of the microfinances

iv. Establish the joint effect of structure-related, market-related and capital-related firm characteristics on performance of the microfinances

1.4   Research Hypotheses

This study tested the following hypotheses:

H_{A1} Structure-related firm characteristics have a significant effect on performance of microfinances

H_{A2} Market-related firm characteristics have a significant effect on performance of the microfinances

H_{A3} Capital-related firm characteristics have a significant effect on performance of the microfinances

H_{A4} There is a joint significant effect of the combined aspects of firm characteristics on performance of the microfinances

1.5   Significance of the Study

Results of the study will be useful to academicians in supporting future studies that is, supplement existing knowledge. Strategic Management scholars will gain insight into how firm characteristics drive performance in the microfinance industry. From academicians' perspective, the results provide a preliminary assessment tool for the measurement of performance and thus provide a starting point for future performance measurement research.

Results will also be useful to practitioners and professionals in the industry. The study will guide microfinances towards implementing performance oriented strategies i.e. policy formulation and implementation. It will provide MFI managers with metric to assess firm characteristics hence understand and predict performance of the firm thus have a base from which to improve. The result of this study could serve as a decision making tool to help microfinance managers maximize the value of their firms.

1.6   Scope and Limitations of the Study

1.6.1   Scope of the Study

This study was carried out in Nakuru in the months of January-February 2013.The population consisted of MFIs operating in Nakuru municipality; a survey on all the

commercial banks undertaking micro finance business, deposit taking microfinance institution and credit only micro finance institution was done. The study sought to determine how firm characteristics affect the performance of microfinances under investigation. The study respondents were managers who were considered most suitable to give the required information.

1.6.2   Limitations of the Study

Research was based on cross-sectional design thus data was collected at one point in time. Therefore the study cannot establish the long term effect of firm characteristics on performance of the microfinance sector. Data was collected from institutions offering microfinance services in one town in Kenya thus generalization will be done with caution.

1.7   Assumptions of the Study

It was perceived that information obtained from the managers was the most suitable for this study. It was also assumed that managers are knowledgeable about firm characteristics and performance. In addition respondents answered the questionnaires with accuracy and with utmost honesty as requested. Finally respondents were representative of the target population.

1.8   Definition of Terms

Characteristic	An attribute towards an organization serving to identify hence makes a firm recognizable and unique.
Enterprise	An organization created for business ventures aimed specifically for growth and profit.
Entrepreneurship	Venturing into organized business activities in an effort to transform innovations into economic gain.
Firm	A business organization set up with the main objective of making profits.
Microfinance	A type of banking service that is provided to unemployed or low-income individuals who are not eligible for formal banking.
Organization	A social unit of people systematically structured and managed to meet a need or to pursue collective goals on

a continuing basis.

Organizational Performance   The accomplishment of a given target in business measured against preset known standards of accuracy, completeness, cost, and profit.

CHAPTER TWO

LITERATURE REVIEW

2.1   Introduction

This chapter discusses literature on firm characteristics and organizational performance. It begins by discussing firm characteristics by categorizing them into structure, market and capital related as well as organizational performance. The chapter discusses the relationship between firm characteristics and organizational performance in context to the microfinance industry. Finally the chapter discusses the conceptual framework of the study.

2.2   Firm Characteristics

Firm characteristics refer to the unique attributes that make an organization distinguishing and standout above others in a particular industry or market (Golan et al., 2003). These are structure-related which include size, age and ownership; market-related which include market orientation and diversification and capital-related that entails capital which plays an important role on business success.

2.2.1   Structure-Related Firm Characteristics

As earlier stated this entails size, age and ownership. The size reflects how large an enterprise is in infrastructure and employment terms. McMahon (2001) found that enterprise size significantly linked to better business performance. Larger enterprises were found to have higher level of success. Firm size is probably one of the single most influential variables in organizational studies. Chen and Hambrick (1995) provide a summary and overview of the importance of firm size. Firm size has also been shown to be related to industry-sunk costs, concentration, vertical integration, and overall industry profitability (Dean et al., 1998). Larger microfinances are more likely to have more layers of management, greater number of departments, increased

specialization of skills and functions, greater formalization, greater centralization, and greater bureaucracy than smaller microfinances (Daft, 1995). Recent research has found an association between firm size and inertia i.e. inadequate or slow adaptation to change or resistance to fundamental changes in conducting business (Miller & Chen, 1994). Inertia can be caused by constraints on action such as bureaucratic rigidity, insularity, and institutional networks, all of which tend to be associated with firm age and size (Meyer & Zucker, 1999). Miller and Chen (1994) argue that inertia can make change more costly and harder to achieve and maintain.

Based on these arguments, firm size is expected to be an important predictor of microfinance performance. The widely accepted view is that implementing quality management effectively requires that firms move away from inspection toward approaches that are based on prevention and customer focus (Deming, 1996). The elements to achieve this include top management commitment, training and education of employees, employee involvement, continuous process improvement, developing long-term relationships with suppliers, and a real focus on quality throughout.

Larger microfinances are more likely to have more layers of management, organized across functional lines, have long standing barriers between functional departments, and have a bigger and entrenched bureaucracy and more inertia to change compared to smaller microfinances. One would expect that larger microfinances experience greater resistance to change and would require higher expenditures to implement and maintain (Kelly, 1992). Furthermore, many of the key elements of quality management already present to some extent in smaller microfinances, lower costs of implementing and maintaining (Struebing & Klaus, 1997). Larger microfinances may also find it more difficult to maintain an atmosphere of continuous improvement. Hence, maintaining an effective quality implementation is likely to be more difficult for larger than smaller microfinances.

The size of a firm is one of the major drivers of operational costs. Gonzalez (2007) points out large microfinances are more productive in terms of average cost per borrower and also have better write-off ratios. He also found that bigger microfinances are associated with smaller average costs making them more efficient. Similarly, Usman and Zahid (2011) found that larger microfinances have higher ROA, ROE and operational self-sufficiency. Small microfinances not only find it

difficult to compete with larger MFIs in the market but they also face problems in obtaining finance, thereby hampering their ability to grow. For example, Heshmati in Usman and Zahid (2011) examined the relationship between size and sales growth among a large number of small firms in Sweden documented from 1993 through 1998 and found that sales growth was higher in larger firms compared to the smaller ones.

The financial determinants of economies of scale occur due to size where large microfinances enjoy better interest and discount rates due to trading in large quantities. Large microfinances enjoy economies of scale and higher negotiation power over their clients and supplier (Singh & Whittington, 1975). They have easy access to credit for investment and a range of human capital that is qualified. They are also likely to attain greater strategic diversification (Yang & Chen, 2009). The hierarchy in small microfinances puts them in strategic position to counter the disadvantages arising from their size. They experience less agency problems and are more flexible in a changing environment.

Bisher (2012) carried out study to determine the relationship between size and performance of financial institutions in Kenya. The findings of the study showed a weak relationship between size and performance but the relationship was statistically significant.

Age of the firm refers to the length of time that a firm has existed, usually expressed in years and considered an important determinant of performance. According to Usman and Zahid (2011), age related factors can be observed on three different levels: an old organization may have more customers which may drive economies of scale; higher average loan sizes resulting from repeat customers may improve the cost structure and more knowledge about customers may streamline processes.

Length time in operation may be associated with learning curve. Older firms most probably have learned much from their experiences than new comers. Kristiansen et al., (2003) found that length time in operation was significantly linked to business success. Many studies have found that an MFI's efficiency and profitability are strongly related to its age (Gonzalez, 2008). The large pool of customers with an old MFI and the resulting efficiency is therefore, likely to make it achieve a higher growth in outreach and higher AROA and financial self-sufficiency.

Microfinances at the early stage of operation experience difficulties in access to debt finance because of informational disparities. The firm starts to operate and grows to create a reputation on credit history. Credit reputation reduces the moral hazard dilemma hence create a path to access debt finance. The longevity of the microfinance stays in operation, the more persistence to unpleasant economic circumstances (Chandler, 2009). A study by Klapper (2010) discovered that MFIs with less than 5 years in operation are less likely to rely on debt financing. Ngoc et al., (2009) supported the argument that younger MFIs face hardship and more costs in accessing external financing from lenders because of information asymmetry. Consequently there is hypothetical existence of a positive relationship between microfinance's age and performance.

Origin is the concept from which an enterprise develops from, founders or the place where it comes from. According to Smallbone et al., (1995), origin of enterprise in firms, where ownership and management were typically combined in one or more individuals and future goals for the business might be determined as much by personal lifestyle and family factors as by commercial considerations. Further, they concluded that one characteristic which distinguishes the best performing firms was their commitment to growth. Also, another characteristic that distinguish high growth firms is their propensity to acquire other businesses.

Experience on the part of the owner/manager contributes to the survival of microfinances. In their study of new firms, Duchesneau and Gartner (1990) found that lead entrepreneurs in successful firms were more likely to have been raised by entrepreneurial parents, to have had a broader business experience and more prior startup experience, and to believe that they had less control of their success in business, than unsuccessful entrepreneurs. They also found that lead entrepreneurs in successful firms worked long hours, had a personal investment in the firm, and were good communicators. Moreover, successful microfinance are those initiated with ambitious goals, and lead entrepreneurs have a clear and broad business idea (Duchesneau & Gartner, 1990). Firms with more than one shareholder when set up were significantly more likely to survive (Westhead et al., 1995). Education and prior experience in business have been seen as critical success factors for microfinances (Yusuf 1995; Wijewardena & Cooray, 1996).

A study by Sheik et al., (2013) on Pakistan microfinances showed that board size was positively related to financial ROA and earnings per share, while managerial ownership was negatively related to ROA and earnings per share. Nichasio (2012) carried out a study in Nairobi County to establish the relationship between management practice and performance he found that key policies on optimal cash utilization and investment had a positive relationship with performance.

Hartarska and Nadolnyak (2007) using positive approach to assess if regulated MFIs achieve better sustainability and outreach found that regulatory involvement does not directly affect the performance both in terms of operational self-sufficiency or outreach. Jansson and Wenner (1997) on the financial regulation and its significance for microfinance in Latin America and the Caribbean found that financial regulation have a negative differential impact on microfinance since they impose restrictions which are costly.

Dietmar et al., (1998) point out that firm with limited liability (incorporated) possess development attributes than firm with unlimited liability. There are numerous aspects that clarify the relationship that exist between incorporation and performance: one, the separation of owner's affairs and business affairs increase the commitment of managers to the firm goals. Two, Publication of their financial statements as one of legal requirement makes corporation's openness for users to know the firm's status including their debt ratio and firm's assets. Cassar (2004) found out that lenders observe incorporation as a good indicator for firm's trustworthiness and commitment to operational laws. Abor (2008) stated that the form of business organization has an effect on equity – debt decisions on MFIs operations. The owners of limited firm have limitations to answer against losses generated by the corporation whereby the owners of unlimited firms are liable up to their personal assets to cover for business losses. Therefore, limited companies prefer to use the equity to finance their projects than debt financing while unlimited firms the only option available to finance their projects is debt financing. The study conducted by Coleman and Cohn (2000) and Fatoki and Asah (2011) evidenced presence of a positive association between legal formation and performance of MFIs.

Claessens et al., (2001) find that foreign microfinances have higher profits than domestic microfinances in developing economies. Berger et al., (2005) postulates that

state-owned microfinances have poor long-term performance, but improve considerably after privatization. Other studies find that generally foreign-owned microfinances suffer disadvantages related to high monitoring costs and information asymmetries compared to local competitors in developing markets (Lensink & Naaborg, 2007; Luo et al., 2009).

Several studies (Bashir, 2000; Berger et al., 2005) have concluded that foreign owned microfinances are more profitable than their domestic counterparts in developing countries and less profitable than domestic microfinances in industrial countries, perhaps due to benefits derived from tax breaks and other preferential treatments. Privately owned microfinances have also been assessed to be more profitable than their state owned (public) counterparts (La Porta et al., 2002). They posit that public microfinances' low profitability is due to the fact that, rather than maximizing profits, they respond to a social mandate.

Based on agency and resource dependence theory various stakeholders influence MFI performance through their participation in boards. Other papers have adopted similar approaches and have highlighted the importance of MFIs' legal status for their performance (Mersland et al., 2011). The results indicate that nonprofits and credit unions are able to achieve better social results but deposit taking institutions have higher efficiency compared to other organizations. They concluded that internationally connected MFIs perform better than local competitors other factors being equal.

Education and experience of CEOs are some of the criteria considered when hiring a CEO. The focus is on whether such attribute has an impact on MFI performance. A study on CEO experience and firm performance (Guthrie & Datta, 1997) indicate that experience of CEO has a positive relationship with microfinance performance. Another study by (Soriano & Castrogiovanni, 2012) found that CEO experience has a positive influence on MFI productivity.

2.2.2   Market-Related Firm Characteristics

Market-related variables include orientation and diversification. Market orientation places the customer at the center of all the activities of an organization. It aims at customer satisfaction which occurs when the products offered by the firms meet the

expectations of the customers. This appears as an important factor leading to superior performance in organizations. Market oriented microfinances are likely to achieve long-term profit by continuously providing superior value to customers through identifying their current and future needs, knowing the strengths and plans of competitors and responding to them in a coordinated manner. The potential of market oriented firms to achieve superior performance has been examined and found by a number of researchers in various industries (Deshpande et al., in Usman & Zahid, 2011). Goldberg (2005), cautions that the designers of financial service for the poor people need to recognize that the 'poor' are not a homogenous group with broadly similar needs. Aghion and Morduch (2005), concur that clients have many different needs which vary with the season, stage of life, means of gaining livelihoods and a host of contingencies.

Usman and Zahid (2011) point out that market orientation creates a unique culture inside an organization in which employees from all departments/functions participate in identifying and satisfying the needs of the customers, keeping in account the strengths and activities of their competitors. These coordinated, customer oriented and competitor oriented activities result in creating superior values for customers, enabling organizations to attain competitive advantage that leads to superior organizational performance. Customer satisfaction enables the MFIs to retain not only the existing customers for longer period but also help them in attracting new customers through the positive word of mouth communication of the current satisfied customers (Kohli & Jaworski, 1993).

Customer retention, which is the outcome of customer satisfaction, has been found to significantly improve the profitability of MFIs. A study by Reichheld and Sasser (Usman & Zahid, 2011) found that firms can improve profits from 25% to 85% by making an improvement of only 5% in their customer retention. Furthermore, they found that if 2-5 percent of the additional customers are retained, it has the same effect on the profit as cutting the costs by 10%. They point to the increased cost of attracting new customers. According to Usman and Zahid (2011), it costs about five times more to attract a new customer than to retain an existing one. They provide several reasons to justify why retained customers are more profitable than the new customers. First, the greater understanding and collaboration with the existing

customers help in reducing the costs as it becomes easier to sell. Second, the loyal customers are often not sensitive to prices and are therefore, less inclined to switch to competitors when the prices are increased. Finally, satisfied customers recommend the products to others. This significantly reduces the cost of acquiring new customers, thereby, increasing the profit generation of the firm.

Singh (as cited in Usman& Zahid, 2011), also point out to the role of existing satisfied customers in attracting new customers by stating that those marketers who understand the impact of customer satisfaction on firm performance will try to use the recommendations of the currently satisfied customers as the basis for securing future sales orders from new customers. In addition to positively influencing the customer satisfaction and retention, market orientation also increases employee commitment towards the organization which ensures customer satisfaction leading to the retention of existing customers and attraction of new ones (Kohli & Jaworski, 1993). Allen and Wilburn (2002) also assert that higher customer and employee satisfaction positively affects customer retention which leads to greater market share, an important predictor of profitability.

Thus, a market oriented microfinance which focuses on identifying the current and potential needs of the clients and responds to them in a coordinated manner by offering better products than competitors performs better in terms of customer satisfaction which ultimately leads to increased sales growth and profitability. The positive link between market orientation and organizational performance measured in terms of sales growth and profitability suggest that a microfinance which determines the perceptions, needs and wants of the poor in the best manner and satisfies them by designing, communicating, pricing and delivering appropriate and competitively viable products is expected to have a higher growth in outreach and profitability (Usman & Zahid, 2011).

Financial engineers have placed greater emphasis on being able to tackle the new challenges by innovating new products, better processes and implementing more effective solutions to tackle the increasingly complex financial problems (Tufano, 2002). Financial innovation therefore represents a systematic process of change of instruments, institutions, operating procedures and policies that determine the

products and the structure of our financial system. Lariviere and Martin (1998) classified micro finance innovations into various categories.

System innovation can be termed as deliberate changes in the systems employed from manual book records to interconnected computer systems and currently to interconnected financial and other institutions. According to Omasaja (2007) asMFIs scale up their activities, the staff and the managers get overwhelmed by volume of tasks, necessitating for the need for better systems that are faster, effective in reports generation, improve performance and support high volume business.

Financial institution innovation is the introduction of new institutions or redesigning of the institutions to strategically serve the target market segments appropriately. It involves merging, splitting institutions to their specialties or inclusion of the related services. This enables these institutions to maximize on capital and serve different target groups effectively. Institution innovation has introduced economies of scale and the uses of technology and effective innovations have brought costs and interest rates down for MFIs. It has brought a vast opportunity for MFIs to offer more micro financial products to both rural and urban households under one roof. These include additional loan products, such as housing, auto and education; new insurance schemes for health, life, and assets, bills payment and money remittances, hence benefiting through economies of scale.

Process innovations are technological processes that increase efficiency and effectiveness with regards to payment systems, communication, computing and transactions clearing methods. These are aimed at reducing transaction costs, reduce idle cash balances in response to higher interest rates and take advantage of quicker computer transactions (Finnerty, 1988). Among the most notable differences of MFIs is the secularization feature during the loans processing. The very nature of its clientele lacks the collateral to back up their loan facility. All these aim at reducing transaction costs, time, maintaining clients and better portfolio management to increase the overall microfinance's success (Kihumba, 2010). Process innovation will continue to be very important to microfinance growth for the reason that without excellence process innovation, other innovations will be impossible to implement.

Firm diversification refers to expansion into new areas of business, or expansion of a commercial organization into new areas. Many researchers have studied the relationship between firm diversification and performance. Datta et al., (1991) and Hoskisson & Hitt (1990) provide excellent surveys, analyses, and critiques of previous findings. An important observation in these studies is that there seem to be no consistent or conclusive findings between firm diversification and performance. Interestingly, Stimpert and Duhaime (1997) argue that the inconsistencies are due to the fact that diversification impacts other variables, which in turn determines firm performance. For example, they suggest that diversification may influence performance indirectly by increasing administrative complexity and bureaucratic costs. In fact, their study shows that diversification has a negative relationship with the amount of R&D spending. Thus, diversification may impact negatively the amount of strategic investments in the development of new product or process technologies.

Given that performance represents an investment in improving products and processes, Stimpert and Duhaime's (1997) results may argue for a negative relation between firm diversification and performance. Since firm size and diversification are positively correlated (Daft, 1995), the arguments about inertia and constraints on action related to firm size could also apply to diversification. Further a less diversified firm operates in one or few industries, the different operating units in a less diversified firm are likely to be very similar in terms of organizational culture, technology, operating procedures, and competitive priorities. Therefore, the lessons learnt from a successful implementation of quality management in one operating unit can easily and efficiently be implemented in other operating units. More specifically, the approaches, procedures, techniques, and systems developed at one operating unit should be applicable and transferable at low cost to other operating units. Furthermore, as operating units gain experience with quality, the specific knowledge created in the process can be transferred at low cost to other units. Synergies among product quality improvements are more likely. A higher quality product in one area is more likely to reflect well on similar products in related areas.

On the other hand, since a more diversified firm operates in many industries, the different operating units are likely to differ significantly in terms of organizational

culture, technology, operating procedures, and competitive priorities. Therefore, the approaches, procedures, and systems necessary to maintain an effective quality implementation would differ across different operating units. Each unit would have to invest resources to identify what works best for that unit. The learning and knowledge gained in one unit would be harder to transfer and apply to other units, other products, and other markets (Daft, 1995; Datta et al., 1991).

Products innovation is products diversification through the development of either new instruments or modification of the existing financial products and services to align them with the clients' needs. Product innovation can also be seen as bringing to life a new way to solve the customer's problem that benefits both the customer and the microfinance. Products invention is done though the ongoing research and development of new products, services or ideas which are more flexible and tailor made to satisfy customers. Product innovations specific to MFIs, all focus towards providing a wider range of financial products and intermediation options. These innovations give a launching pad and a competitive edge to MFIs. For instance flexible savings facilities, loans to farmers, students, business people, asset financing among others. Likewise, there are also different accounts for short-term and long-term saving/investments (Tufano, 2002).

Of late more MFIs are collaborating with telephone operators in money transfer, generating value to clients by enabling clients transfer or deposit money straight into the accounts. The partnerships and collaboration has increased the distribution channels and has reduced transaction cost, time, provided convenience and accessibility for the customer, hence increasing revenue and market share (The pillar, 2009). Other MFIs with fully developed regional network are forming strategic alliances with international donors, to act as the strategic advisor and distributor of donor funds targeting low income rural and marginalized communities to support their economic activities. Other MFIs are often used by donors to access distant clients, evade corrupt government agencies hence they enable close monitoring of the funds application (Mbogo & Ashika, 2011).

2.2.3 Capital-Related Firm Characteristics
Capital is material wealth in the form of money or property i.e. resources that can be used to generate economic wealth obtained either internally or externally. In a study

in Australia, McMahon (2001) discovered that greater dependence upon external finance was associated with better business growth. Another study in Indonesia by Kristiansen et.al (2003) found that financial flexibility was significantly correlated to business success. The firms that took advantage of family and third-party investment experienced higher level of performance.

The capital structure is described as the mix of debt and equity that a firm uses to finance its operations (Gitman, 2003). The original hypothesis of capital structure originated from the Modigliani-Miller theorem which argued that the value of the firm is irrelevant in financing decisions in a perfect market (Modigliani & Miller, 1963). Therefore, it is possible to reduce firm's costs of capital and maximize shareholders' wealth by employing debt. Tax saving makes debt finance cheaper than equity finance whenever employed in a firm's capital structure.

Debt and equity are the two different sources of funds for microfinance. As both involve costs to the firm, there is a need for the firm to choose the right option that minimizes its costs. In most cases, firms tend to choose to create the right combination of debt and equity that might result in the lowest costs. Thus, the use of debt and equity proportions are the measurement tools for capital structure. Glen and Pinto (1998) describes that determining debt and equity is an important financial decisions faced by MFIs. Capital structure defined as total debt to total assets at book value influences both profitability and riskiness of the microfinance.

Hence, capital structure concerns the relative proportions of debt and equity financing that helps MFIs to minimize their overall financing cost (cost of capital). However, lowest cost (discount rate) is actually maximizing their market values (maximizing the present value of dividends). With this view, the discount rate is the cost of capital that can also be formulated as Weighted Average Cost of Capital (WACC).

Financial risk refers to an increase in volatility or uncertainty of a company's earnings due to borrowing. Studies indicate that microfinances without borrowings (unlevered firms) show less fluctuation in their earnings, whereas, those with borrowings (levered companies) show greater fluctuation in their earnings when there are changes in their financial performance. Hence, some specific implications of borrowing on levered firms could be outlined as follows; borrowings require interest payments that

in effect, slash MFIs' net incomes, interest expenses as fixed costs that increase the volatility of net incomes and thus, affect EPS and borrowings also relatively reduce the proportion of the equity in a company's capital structure and hence, reduce the number of shares outstanding (Glen & Pinto, 1998).

Glen and Pinto (1998) highlight two main reasons why to expect performance to be related to the capital intensity of the microfinance. First, the high degree of automation in higher capital-intensive firms may already enable these firms to have a high degree of inherent process control. Hence, the potential for process improvement from quality management practices may be less. On the other hand, in lower capital-intensive (more labor intensive) MFIs, the lack of automation and the dependence of process control on the skills and motivation of the workforce are likely to offer more opportunities for process improvements. Hence, the potential for cost reductions from adopting performance practices may be higher for lower capital-intensive environments than higher capital-intensive environments. Second, an important component is the implementation of work practices such as employee training, information sharing, involvement, and empowerment.

Employees are the driving force for improvements originating from activities such as quality circles, cross-functional teams, process improvement teams, customer orientation, and suggestion plans. Clearly, the opportunities for gains from these activities are likely to be higher in a lower capital-intensive environment than in a higher capital-intensive environment (Kristiansen et al., 2003).

Various studies suggest that microfinances with higher levels of capital perform better than their undercapitalized peers. Staikouras and Wood (2003) claim that there exists a positive link between a greater equity and profitability. Abreu and Mendes (2001) also trace a positive impact of equity level on profitability. Goddard et al., (2004) supports the prior finding of positive relationship between capital/asset ratio and earnings. According to Samuels and Smyth (2008), larger microfinances tend to have lower debt to equity ratios which lead mechanistically to lower levels of variance in return on shareholders' equity.

Microfinance deposits represent the liquid form of money. On a micro economic level, microfinance represents the primary source of credit to most small businesses

and many individuals. Omutunde (2002) asserts that, a sound financial system will contain, predominantly, microfinance with adequate capital to withstand the most probable adverse shocks, and will have staff skilled in assessing conditions and coming up with solutions to manage liquidity, credit, market and other risks.

According Llewellyn (1992), competitive and regulatory pressures are likely to reinforce the central strategic issue of capital and profitability and cost of equity capital in shaping microfinance strategy. In order to assess and manage risks, microfinance must have effective ways of determining the appropriate amount of capital that is necessary to absorb unexpected losses arising from their market, credit and operational risk exposures. In addition to this, profits that arise from various business activities of the microfinance need to be evaluated relative to the capital necessary to cover the associated risks. These two major links to capital and risk as a basis to determine capital and the measurement of profitability against risk-based capital allocations, explains the critical role of capital as a key component in the performance of MFIs.

Leverage is an important determinant of the capital structure of a new firm. The extent to which the firm's assets are tangible and generic would result in the firm having a greater liquidation value, (Titman et al., 1988). Studies have also revealed that leverage is positively associated with the firm's assets. This is consistent with Myers (1977) argument that tangible assets can support a higher debt level as compared to intangible assets. Assets can be redeployed at close to their intrinsic values because they are less specific. Thus, assets can be used to pledge as collateral to reduce the potential agency cost associated with debt usage. Stulz and Johnson (1996), provide empirical evidence of a positive relationship between debt and fixed assets. The empirical evidence suggests a positive relation consistent with the theoretical arguments between asset structure and leverage for microfinances, (Van der Wijst & Thurik, 1993).

Lokong (2011) carried out a study on the relationship between capital structure and profitability MFIs in Kenya and found a positive relationship between capital structure and profitability thus concluded that most MFIS in Kenya were using more equity than debts. Orua (2009) studied the relationship between capital structure and financial performance of microfinances in Kenya and concluded that such relationship

could not be clearly observed and they were inferred from capital structures of MFIs which were perceived to be performing well. She also concluded that capital structure influences the performance of corporate entities. Highly leveraged MFIs performed better by reaching out more clients.

2.3   Organizational Performance

With the increasing number of analyses and research papers referencing performance, there is a need to have basic understanding of definition of performance and its various measures (Burkhardt, 2013). Therefore, choosing a particular measure of performance depends on how well it meets the intended purpose. Therefore we can say that performance of microfinance is its ability to employ the available resources to increase shareholders' wealth and generate sustainable profits to strengthen its capital base through retained earnings to ensure future profitability

Organizational performance refers to the firm's success in the market, which may have different outcomes. Performance is a focal phenomenon in business studies; however it is also complex and multidimensional. It can be characterized as the firm's ability to create acceptable outcomes and actions (Reed et al., 2000). Performance relates to the achievement of goals and objectives in whatever sector of human life. In business, it is a key term in the field of management, although it is not always explicitly stated. Success and failure can be interpreted as measures of good or indifferent management. In business studies, the concept of success is often used to refer to a firm's financial performance. However, there is no universally accepted definition of performance, and business performance has been interpreted in many ways (Foley & Green 1999). Hence, performance can have different forms, e.g. survival, profit; return on investment, sales growth, number of employees, happiness, reputation, etc. In other words, performance can be seen to have different meanings by different people. In spite of these differences, people generally seem to have a similar idea, i.e. of what kind of business is successful.

Performance measurement in all sectors of the economy is a growing phenomenon worldwide. According to Lye (2004) and Thomas (2007), the objective of performance measurement is improvement, learning and change. The argument then is if performance measurement results obtained are not used as a tool for positive improvements, then it defeats the purpose of developing measures of performance.

Goldstein (1996) stated that determinants of microfinance performance can be grouped into two categories, namely internal and external factors. Internal determinants of profitability, which are within the control of management, can be broadly classified into two categories, i.e. financial statement variables and non-financial statement variables. While financial statement variables relate to the decisions which directly involve items in the balance sheet and income statement; non-financial statement variables involve factors that have no direct relation to the financial statements. The examples of non-financial variables within this category are number of branches, status of the branch (e.g. limited or full-service branch, unit branch or multiple branches), location, size. Sudin (2004) stated that external factors are those factors that are considered to be beyond the control of the management. Among the widely discussed external variables are competition, regulation, concentration, market share, ownership, scarcity of capital, money supply, Interest rate spread, and inflation size.

The microfinance participation in several developing economies is escalating from time to time. Various studies on different countries on the performance of the MFIs confirm this (Adongo & Stork 2005, Meyer 2002, Cull et al., 2007). For example, in Bangladesh a MFI called Grameen Bank at the end of 2000 reported 2.4 million members, where 95 percent of them are women, with $225 million outstanding loan. In addition, Thailand also has reported impressive outreach through agricultural lending by the Bank for Agriculture and Agricultural Cooperative (Meyer, 2002). In general, a number of MFIs have registered impressive outreach in several developing economies including India, Cambodia etc.

A survey by Cull et.al (2007) on the performance of leading MFIs in 49 countries found over half of surveyed MFIs are profitable after making adjustment of subsides. It also identified no evidence of tradeoff between being profitable and reaching the poor. Lakew (1998) examines micro financing program contribution to poverty reduction. He found that after the credit program employment opportunity for the beneficiaries have been created. He also noted that the credit program had positive effect on income and saving of the clients.

Similarly, Aklilu (2002) reviewed the importance of MFIs in developing economies based on countries' experiences. In the review she suggested for promotion of the

existing well developed institution to facilitate growth of formal MFIs. Borchgrevink et.al (2005), studied marginalized groups, credit and empowerment for the case of Dedebit Credit and Saving Institution (DECSI) of Tigray. Through two-phase assessment, the study found that the DECSI's program has had a positive impact on the livelihood of and as well enhanced the social and political position of many clients. However, credit is not the main constraining factor for expanding economic activity, except in urban areas. The study further noted DECSI's heavy involvement in credit delivery in the region has more or less satisfied to most of the people with some exceptions in the urban areas.

There are various ways through which microfinance performance can be measured. European Central Bank (2010) report has categorized them in to three major categories which are traditional, economic and market based measures. The traditional measures are similar to those used by other firms which include ROA which is the net income for the year divided by the total assets. The other measure is ROE which is the internal performance measure of shareholder's value and this is the most famous measure of financial performance. The economic measures of performance aim at assessing the economic results generated by the MFI from its economic assets. The market based measures depend on the way the capital market value the performance of firm as compared to its economic and accounting value.

The main measure of performance is through ratio analysis which has been identified as convenient and efficient method of assessment since it combines information from financial statements and comes up with numbers that are more easily interpreted, (Burkhardt, 2013). Financial measures are regarded as "lag" indicators of performance whereas Intellectual capital measures (like non-financial measures) are regarded as "lead" indicators since they are mainly intended to generate future earnings power (Kaplan & Norton, 2001). While all future earnings are uncertain, it is greater for intellectual capital than for tangible assets. Traditionally, firms relied on their tangible assets to drive their performance and firm-level strategy.

An important issue raised in the literature on microfinance is the sustainability of microfinance programs. Providing microfinance is a costly business due to high transaction and information costs. At present, a large number of microfinance programs still depend on donor subsidies to meet the high costs, i.e. they are not

financially sustainable. In the 1990s, the importance of financial sustainability of microfinance institutions gave rise to an important debate between the financial systems approach and the poverty lending approach (Robinson, 2001). If both approaches agree on the ultimate goal, which is to serve as many poor people as possible in a sustainable way, the means by which these goals should be reached differ fundamentally.

The financial systems approach, on the one hand, emphasizes the importance of financial sustainable microfinance programs. On the other hand, the poverty lending approach concentrates on using credit to help overcome poverty, primarily by providing credit with subsidized interest rates. Ultimately, the debate comes down to the question whether subsidizing interest rates is justified. The advocates of the poverty reduction approach would argue that the poor cannot afford higher interest rates; hence that financial sustainability ultimately goes against the aim of serving large groups of poor borrowers. The financial services camp, however, claims that empirical evidence neither shows that the poor cannot afford higher interest rates nor that there is a negative correlation between the financial sustainability of the institution and the poverty level of the clients.

The debate between the two approaches has not been concluded yet, although the most recent microfinance paradigm seems to favor the financial systems approach. The main argument to support this view is that large-scale outreach to the poor on a long-term basis cannot be guaranteed if microfinance institutions are incapable of standing on their own feet. Nonetheless, there remains a huge variety in microfinance institutions, some of which can be characterized as subsidized credit institutions, whereas others are becoming sustainable commercial financial institutions.

This new microfinance paradigm has stimulated research on performance and efficiency of microfinance institutions. Hulme and Mosley (1996), for instance, provide alternative measures of performance of some MFIs. By using the Subsidy Dependence Index (SDI) devised in Yaron (1992), indicating how much higher the interest rates charged to borrowers would have to be in order for the institution to cover all operating costs, Hulme and Mosley show that almost all institutes in their sample are still subsidy dependent. Morduch (1999) provides a similar calculation for

the Grameen Bank. He shows that, in order to become subsidy independent, the Grameen Bank would have needed to increase the lending rates by some 75%.

The study by Cull et al., (2007) provides a new dimension to the existing literature on performance of microfinances. The authors explicitly explore whether there is empirical evidence for a trade-off between the depth of outreach and profitability. They examine whether more profitability is associated with a lower depth of outreach to the poor, and whether there is a deliberate move away from serving poor clients to wealthier clients in order to achieve higher sustainability (mission drift). They also test whether a rise in lending rates causes a deterioration of the loan portfolio due to adverse selection and moral hazard.

The Kenyan financial sector is one of the broadest and most developed in sub-Saharan Africa, with 45 financial institutions, including 43 commercial banks and 2 mortgage finance companies (Omino, 2005). These banks make up Kenya's formal banking sector and serve 22.6 percent of Kenya's adult population, according to survey results published in early 2009. Non-bank financial institutions, including MFIs, savings and credit cooperatives, and mobile phone service providers serve another 17.9 percent of the population, bringing the total served by formal financial services to 40.5 percent. Another 26.8 percent of Kenyans rely on the informal financial sector, including NGOs, self-help groups, and individual unlicensed money lenders, and 32.7 percent of the population does not use any form of financial services (Omino, 2005).

Given the shallow reach of traditional forms of banking, microfinance has played a central role in the evolution of Kenyan financial services. Four of Kenya's major commercial banks have roots in microfinance: two as building societies, one as an NGO, and another as a cooperative society. These commercial banks, along with a wide variety of registered microfinance institutions, savings and credit cooperatives, and NGOs, make up Kenya's microfinance industry. The Central Bank reports that as of December 2011, the 52 retail MFIs (excluding commercial banks) registered with the Association of Microfinance Institutions (AMFI) had 1.44 million active deposit accounts/clients at their 825 branch offices, an increase of over 400,000 from the previous year. Excluding commercial banks, the value of total deposits was 202 million USD, up from 151 million USD the previous year. These institutions had 1.27 million active loan clients in aggregate at the end of 2008, an increase of over 30

percent from the previous year, and a total of 443 million USD in gross loan portfolio (Omino, 2005).

Microfinance institutions, regardless of their social mission, are financial intermediaries. Therefore, it should be financially viable and sound to achieve its mission. Most of the MFIs were doing well in terms of operational and financial self-sufficiency. Half of the MFIs were not good in using retained earnings and donor money to become sustainable but most of them were brilliant in managing their assets to optimize profit. In general, during the year 2006 MFIs were doing well (G.O.K, 2006).

According to Omino (2005), Most MFIs used the highest portion of the assets to their primary activity (making loans to micro entrepreneurs). A low cost of funds results from an MFI gaining access to deposits and /or borrowings at a reasonable cost. In this respect all MFIs were successful in obtaining funds at an average interest rate below commercial banks' lending rate (7%). And cost of fund was high in the year 2005 in all institutions but below the lending rate of commercial banks. In the five years of operation, there was a steady growth in the proportion of debt to equity. In addition, full-fledged microfinance units have been established in the Ministry of Finance (the Treasury) and The Central Bank of Kenya to formulate policies and procedures to address the challenges facing microfinance institutions, especially in the rural areas, and also build a database to facilitate better regulation and monitoring of their operations (G.O.K, 2006). This bill has seen some microfinance institutions transform to formal banking, for example Equity bank and Family Finance Bank while others have tried to make a move in vain.

Mcdonald (1999) suggests that the environment in which microfinance institutions operate influences their operations and hence their profitability. As Staikouras and Wood (2003) posit financial market structure, the economic condition of the country, the legal and political environment all may influence the performance of MFIs. Since MFIs mostly deal with credit facilities, the size of credit portfolio influences their profitability i.e. a large credit portfolio imply improved profitability. However, since substandard credits are a source of heavy financial losses to financial institutions and have actually been held responsible for numerous financial institution failures, the degree of risk of the credit portfolio need to be well managed (Olajide, 2006). The

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stability of political environment and an enabling macro economy may also directly or indirectly affect the profitability of the MFI. According to Perry (1992), the effect of inflation on MFIs performance depends on whether the inflation is anticipated or unanticipated. In the former case the interest rates are adjusted accordingly resulting in revenues, which increase faster than costs, with a positive impact on profitability. In the latter case the MFIs may be slow in adjusting their interest rates, which results in a faster increase of MFIs costs than revenues that consequently have a negative impact on profitability.

2.4   Firm Characteristics and Organizational Performance

The determinants of firm performance have long been of central interest to strategic management researchers (Rumelt et al., 1994). Performance is often defined simply in terms of output such as quantified objectives or profitability. Brumbach (in Armstrong, 2006) defines performance as both behavior and results. This covers the achievement of expected levels as well as objective setting and review. The underlying thought is to investigate this relationship bearing in mind that if the firm characteristic is appropriate, then the expected levels of output will be achieved (success) and vice versa for failure. Success and failure are taken as the two ends of the performance continuum.

Various scholars have tried to set out a clear definition of microfinance performance (Chu-Hua et.al., 2001), but this debate continues to date within the academic literature, more so regarding some aspects of terminology issues, analytical levels, and the conceptual basis for assessment. According to Ginsbert and Venkatraman (1985), there are three different levels of performance within micro finances. They are distinguished as the financial performance, business performance and organization effectiveness, although the latter has been subsequently known as organizational performance (Terziovski & Samson, 2000). Performance is the key interest of every business manager or owner. The overall performance depends on strategic fit of firm characteristics and objectives. Organizational performance is measured by how relatively efficient a microfinance is in converting strategic assets, as defined by the resource-based view, into performance.

The search for an ideal or perfect structure is about as futile as trying to find the ideal canned improvement process to drop on MFIs. It depends on the microfinance's

context and focus (vision, values, purpose), goals and priorities, skill and experience levels, culture; teams' effectiveness and so on; each is unique to any organization (Clemmer, 2006).

Empirical research and experience shows that the shape and characteristics of high performing MFI structures have a number of common features. First intense customer and market focus where systems, structures, processes, and innovations all aim at and flow of the market and customers. Field people and hands-on managers drive the MFI in daily contact with customers and partners. Next team-based where operational and improvement teams are used up, down and across. A multitude of operational teams manage whole systems or self-contained subsystems such as regions, branches, processes, and complete business units (DeVaro & Kurtulus, 2006).

Further highly autonomous and decentralized where dozens of mini-business units or businesses are created throughout a single firm. Local teams adjust their MFI's product and service mix to suit their market and conditions. They also reconfigure the existing products or develop prototypes to meet customer/partner needs. Moreover there is servant-leadership where senior managers provide strong context, focus and strategic direction to guide and shape the firm. Very lean and keen staffs serve the needs that customers actually care about and are willing to pay for. Support systems are designed to serve the servers and producers, not management and the bureaucracy (DeVaro& Kurtulus, 2006).

Networks, partnerships, and alliances exist where MFI and departmental boundaries blur as teams reach out, in, or across to get the support to meet client needs and develop new markets. Learning how to partner is fast becoming a critical performance skill (DeVaro & Kurtulus, 2006). Also we have fewer and more focused staff professionals in which professionals are either in the midst of operational action, or they sell their services to a number of teams. Many teams are also outsourcing as needed. Few management levels where spans of control stretch into dozens and even hundreds of people to one manager. Effective managers are highly skilled in leading, directing, and developing. Finally, one customer contact point where internal service and support systems serve the needs of the person or team coordinating and managing the customer relationship (DeVaro & Kurtulus, 2006).

2.5   Theoretical Framework

This section discusses the theoretical framework of resource based view theory and upper echelon theory. It explains the theory and applicability of these theories in determining the influence of firm characteristics on microfinance performance. The resource based view theory argues that collections of resources within MFI enable it to have unique attributes hence better performance (Barney, 1991; Penrose, 1959).

The theoretical application of firm characteristics may improve, reduce, or have no effect on organizational performance of microfinances. The objective is to develop a descriptive model of the value generating process. The primary theory base is the resource-based view (RBV) of the firm, which combines the rationale of economics with management perspective. The theory emphasizes heterogeneous firm resource endowments as a basis for competitive advantage. It is grounded in the seminal work of economists concerned with firm heterogeneity and imperfect competition (Chamberlin 1933; Robinson 1933). In her theory of firm growth, Penrose (1959) refines these ideas by conceptualizing the firm as a bundle of resources within an administrative framework. Evolutionary economists combining Schumpeterian competition with tacit processes and routines further extend thinking away from static equilibrium models of classical microeconomics (Nelson & Winter, 1982). A seminal contribution to resource-based theory is provided by Wernerfelt (1984), who proposes the notion of resource position barriers, i.e., barriers to imitation, and links resource attributes to profitability. Subsequent research studies examine how resource attributes lead to competitive advantage (Amit & Schoemaker,1993; Dierickx & Cool, 1989; Peteraf, 1993) and extend the RBV in various ways, including the analysis of resources in the context of interconnected organizations (Dovev, 2002).

In contrast to undifferentiated factor inputs with well-defined property rights, resources are firm-specific, difficult to imitate, and often valuable that is, they enable the microfinance to improve efficiency (Teece et al., 1997). Barney (1991) specifies the conditions required for a resource to confer a competitive advantage. If the valuable resource is also rare that is, few MFIs have access to it, it confers a temporary competitive advantage.

Based on the analysis of how other researchers have modeled microfinance business value, we conclude that the locus of microfinance business value generation is the

organization that invests in and deploys firm characteristics. But contextual factors also play a role in shaping the extent to which microfinance value can be generated and captured. In particular, the competitive environment – including industry characteristics and trading partners – as well as the macro environment are salient to microfinance value generation. We therefore derive an integrative model of microfinance value that comprises three domains namely structure related, market related and capital related firm characteristics. Using the resource-based view as a primary theoretical lens, the model describes how internal factors in the form of firm characteristics are key determinants of organizational performance.

2.6   Conceptual Framework

This study examined the firm characteristics as a critical factor affecting organizational performance of microfinances. The model adopted describes the variables and interrelationship amongst them as illustrated in figure 1 below.

Moderating Variable

Contextual Factors
- Organizational structure
- Environmental factors
- Strategy

Independent Variables

Dependent Variable

Firm Characteristic
   Structure-related
- Firm size
- Ownership
- Firm age

Market-related
- Market orientation
- Diversification

Capital-related
- Capital

Organizational Performance
- Branch network
- Number of clients
- Collection performance
- Financial sustainability
- Efficiency

Figure 1: Relationship between firm characteristics and performance.

According to figure 1, the dependent variable is performance while the independent variables are firm characteristics. Firm characteristics were categorized as structure, market and capital related variables. These characteristics effect on the performance of MFIs is moderated by the influence of contextual factors. Much evidence from literature has supported the existence of a positive relationship between firm size and performance. Firms with proportionally higher debt in their structure of capital are prone to be lower performers. Low concentration of ownership causes conflict of

interest between the shareholders and management. The rationale for firm age has the possibility that old firms might have improved their practices over time. Leading firms operating in a particular industry could produce a bandwagon effect on the level of performance adopted by other firms working in the same industry. Higher profitability might induce management maximize the resources and to increase sustainability. Firms enjoying a sound financial position, more specifically higher liquidity are more inclined to better performance. The performance is usually evident in the form of branch network, number of clients, sustainability and efficiency. These can be validated if the MFI is reaching out to the customers that it's intended to, aiding entrepreneurs to alleviate poverty as well as being able to have vibrant financial sustainability and efficiency.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1   Introduction

This chapter discusses the methodology used in the research. It begins by describing the research design followed by target population and how data was collected. In addition reliability and validity test are also discussed. Finally the discussion concludes by describing how data collected was analyzed.

3.2   Research Design

The study was conducted using correlation study design to show the nature of relationship between firm characteristics and performance. The relationship between firm characteristics and performance is best handled using correlation analysis as it is a joint relationship of the variables but not a causal relationship, where it showed the nature of the relationship between the research variables and the direction of the relationship (Mugenda, 2005).

The data collected were both qualitative and quantitative in nature as it attempted to collect data from members of a population in order to determine the current status with respect to one or more variables. The design made it possible for the researcher to have a systematic collection and presentation of data thus determine the effect of firm characteristics on the performance of MFIs in Kenya.

3.3   Target Population

The target population is defined by Best and Kahn (1998) as the totality for observation and analysis. Kasomo (2007) says target population should be explicitly and unequivocally defined. The population of this study entailed all the MFI operating within Nakuru Municipality. There are 48institutions offering microfinance services operating in Nakuru Municipality (Nakuru Municipal Council, 2012).

3.4   Study Design

The study conducted a census on all the 48 microfinance institutionsregistered with Association of Microfinance Institution (AMFI) operating in Nakuru town.The number was considered small not to warrant sampling. Furthermore, it was convenient and affordable to obtain data from all the subjects under investigation.

3.5 Data Collection

To achieve the objectives of the study, both primary and secondary data were used.Data regarding firm characteristics and organizational performance was accomplished through self-administered questionnaires. This was administered to the relevant manager who provided the required information. The questionnaire was self-administered to enhance clarification of questions. Care was taken to afford the respondent independence and avoid researcher influence.

3.6 Reliability and Validity

Cronbach's alpha co-efficient was used to test for reliability of firm characteristics and performance instruments. The average Cronbach's alpha coefficient for the firm characteristics instrument was 0.805 and 0.777 for performance. These are above the threshold of 0.7 which is considered acceptable (Sekaran, 2004).A pretest was conducted in order to increase the validity of the questionnaires. Consequently a test-retest approach method was used to further test the validity of the instruments. The design, took into consideration what should be measured and what should not be measured and to what extent hence explanation for relationship noticed.

3.7 Data Analysis

Researcher enlisted the code for the returned questionnaires and entered them into a table. The data gathered was analyzed using descriptive statistics which entailed means, percentages and standard deviation. To examine the relationship between firm characteristic and performance of MFI, Pearson product moment correlation coefficient was employed. To determine the effect of firm characteristics on performance of the MFIs, multiple regression analysis was used. The below multiple regression equation was developed:

$$y = a + b_1x_1 + b_2x_2 + b_3x_3 + e$$

Where;

a = constant

x_1 = structure related firm characteristics

x_2 = market related firm characteristics

x_3 = capital related firm characteristics

b_1 - b_3 = regression coefficients

e = error term

CHAPTER FOUR

RESULTS AND DISCUSSION

4.1   Introduction

In this chapter the research findings and results are discussed. It begins with a brief summary on the background of all the microfinance institutions under study. This is followed by the analysis of the data that was collected. Data on firm characteristics and performance is presented using descriptive statistics in the form of percentages. Also the relationship between firm characteristics and performance was examined and presented using correlation. Finally the effect of firm characteristics on organizational performance was determined and presented using multiple regression.

4.2   Organizational Profile

The research examined the effect of firm characteristics on performance of microfinances in Nakuru. A survey was carried out on all the 48 microfinances within Nakuru registered with AMFI. Out of the 48 microfinances targeted, 45 completed the questionnaires representing a response rate of 93%. From the data collected the MFIs operate independently and are not subsidiaries of any organization. However there are some commercial banks that offer microfinance services hence identified by the name of the bank. Another dominant factor is that most of the MFIs (80%) are located within the CBD of Nakuru. However there are others that are located in the outskirts of the town. This is attributed to centrality thus accessible to a wider catchment of clientele. It is also worth noting that in most MFIs, it's a policy that only managerial staff can share information about the organization to the public. Therefore the respondents in the study were branch managers, loan officers or micro credit officers. This was considerate since it is believed that for one to hold such a position then he must be conversant with operations of the organization. It was also noted that MFIs target the general public but with a lot of emphasis on the low income earners in the society. Thus most clients are the youth and women (72%) even though they still enjoy a clientele from all groups across the market. Though most of the MFIs have a national coverage, it was noted that most of the clients (76%) resided within Nakuru County with a few coming from the neighboring counties. The MFIs concentrate mostly in provision of loans. However, this is supplemented by other back and front office services depending on the clients' preference.

4.3   Firm Characteristics

The firm characteristics that were studied included structure related, market related and capital related firm characteristics.

4.3.1   Structure Related Firm Characteristics

Data on structure related firm characteristics of the institutions offering microfinance service was analyzed in percentages and the results are presented in Table 4.1 below.

Table 4.1 Structure related firm characteristics in percentages

No. Of Branches	Less than 5 26.7	Btwn 5-10 6.7	Btwn 11-20 13.3	Btwn 21-30 26.7	Above 30 26.7
Networth of the firm '000 000'	Below 5 0.0	5 to 10 13.3	Btwn 10-15 0.0	Btwn 15-20 0.0	Over 20 86.7
Average Loan Size '000'	Below 20 0.0	20-40 26.7	40-60 33.3	60-80 20.0	Above 80 20.0
No of employees	Below 100 40.0	100-200 20.0	100-300 0.0	300-400 6.7	Above 400 33.3
Years MFI has been in operation	Below 10 yrs 46.7	10-20 Yrs 33.3	21-30 Yrs 13.3	31-40 Yrs 0.0	Above 41 Yrs 6.7
No of CEOs the firm has had since inception	Less than 2 37.8	Btwn 2-4 48.9	Btwn 5-7 13.3	Btwn 8-10 0.0	Above 10 0.0
The MFI's legal structure	NGOs 0.0	Cooperatives 0.0	Credit Unions 6.7	Non bank 40.0	Banks 53.3
CEOs tenure in office(yrs)	Below 2 13.3	Btwn 2-4 26.7	Btwn 4-6 20.0	Btwn 6-8 33.3	Above 8 6.7
% of manag't board comprising professionals	Below 20 0.0	Btwn 20-40 0.0	40-60 6.7	60-80 0.0	Above 80 93.3

As shown in Table 4.1 over 50% of the MFIs have more than 50 branches of which 27% have over 30 branches. None of the MFIs has a net worth below 5 million. Most MFIs have a net worth of over 20 million which is a massive 86%. Table 4.1 illustrates that none of the MFIs awards loans below 20 thousand. Moreover there are 20% of the MFIs who award loans above 80 thousand. On average most MFIs give loans between 40-60 thousands (33%).Most of the MFI (40%) have below 100 employees. Further 33% of the MFIs, have over 400 employees.

Table 4.1 shows that only 7% of the MFIs have operated for over 40years with none having operated between 31 and 40 years. Most of the MFIs (47%) have operated for less than 10 years. Most of the MFIs (49%) have had between 3 and 6 CEOs since inception. Further there is no microfinance that has had more than 9 CEOs. Majority of the MFIs (33%) have the C.E.O.'s tenure running between 6-8years. The management board of the MFIs (93%) comprises of over 80% professionals. There is no MFI having below 40% professionals in the management board.

It can be seen in Table 4.1 that most MFIs (53%) also operate as banks. However none of the microfinances operates as a cooperative or an NGO. Majority of the microfinances are locally fully owned (93%) while a few have majority local shareholders (7%). However none has equal foreign and local ownership or majority foreign ownership.

4.3.2 Market Related Firm Characteristics

Data on market related firm characteristics of the institutions offering microfinance service was analyzed using percentages. This is summarized in Table 4.2.

Table 4.2Market related firm characteristics in percentages

	Not at all	Little extent	Moderate extent	Great extent	V great extent
Reliance on single product for profitability	60.0	26.7	0.0	6.7	6.7
Firm's involvement in other business	20.0	40.0	20.0	6.7	13.3
Whether firm collaborate with other MFIs	13.3	46.7	13.3	13.3	13.3
Firm's intention to introduce new products	0.0	0.0	0.0	6.7	93.3
Firm's intention to expand to other regions	0.0	0.0	0.0	6.7	93.3

From Table 4.2, most of the MFIs have more than 8 different products of which they have minimal reliance on a single product for profitability. MFIs in a little extent do engage in other business (40%). In a little extent MFIs do collaborate amongst themselves. MFIs have very great intentions of introducing new products (93%) as much they would like to expand to other regions.

Majority of the loans are funded by 20-40% of the savings. However, only 7% of the loans are funded by over 60% of the savings. Savings are sometimes used as a

requirement for borrowing. However this may rarely be used by other MFIs. An enormous 60% of the outstanding loans are accounted by below 20% of the forced savings. Moreover no outstanding loan is accounted for by over 60% of forced savings. Most MFIs offer a minimum loan of between 5 and 10 thousand representing 87%. There is no MFI that offers a minimum loan below 5 thousand. In addition, 13% offer minimum loans of above 20 thousand.

4.3.3 Capital Related Firm Characteristics

Data on capital related firm characteristics of the institutions offering microfinance service was analyzed using percentages. This is summarized in Table 4.3.

Table 4.3 Capital related firm characteristics in percentages

	Never	Rarely	Sometimes	Often	Very often
Access of financial support from the government or banks	0.0	6.7	20.0	46.7	26.7
Dependence on other fixed assets for financial stability	0.0	33.3	40.0	20.0	6.7

As shown in Table 4.3, MFIs often get access to either government or banks for financial support. However there are no MFIs that do not get access to financial support. It is evident that MFIs cannot operate without the support of external sources for financial support. In addition they may sometimes rely on other fixed assets for financial stability. In this case it becomes necessary for MFIs to run other forms of business so as to supplement their capital base.

4.4 Organizational Performance

In terms of the performance of microfinances, it was found that, on average, they have positive ROA. This means that most microfinances are making profits. The value of ROA is positive, which indicates that microfinances having positive returns.

To establish the level of organizational performance of the microfinances, respondents were asked to indicate to what level the aspects of performance had changed in their organization in the last three years. The data was coded in Likert scale of 1 to 5. Averages for each item were calculated and then analyzed using percentages. This is then presented in Table 4.4

Table 4.4 Performance level of MFIs

	Very much decreased (%)	Moderately decreased (%)	Not changed (%)	Moderately increased (%)	Very much increased (%)
Changes in branch network	0.0	0.0	6.7	60.0	33.3
Changes in number of clients	6.7	0.0	0.0	40.0	53.3
Changes in loans recovered	0.0	6.7	13.3	73.3	6.7
Changes in loans volume	6.7	0.0	0.0	46.7	46.7
Changes in funding from donors	20.0	13.3	20.0	33.3	13.3
Changes in financial surplus	0.0	6.7	20.0	46.7	26.7
Changes in the firm's assets	0.0	6.7	6.7	66.7	20.0
Anticipation of funding short fall	77.8	2.2	0.0	6.7	13.3
Changes in the firm's liquidity crisis	86.7	0.0	0.0	13.3	0.0
Firm experienced positive cash flow	6.7	0.0	6.7	40.0	46.7
loan processing period	6.7	0.0	0.0	20.0	73.3

From Table 4.4, loans volumes have moderately and very much increased for most MFIs giving an average of 46% in each case. Loans recovered for most of the MFIs have moderately increased 73%). Funding from donors seems inconsistent with no major dominant trend in change though it seems to have moderately increased. The client level has very much increased (53.3%) for most microfinances with few having moderately increased. Financial surplus have moderately increased (46.7%) for the MFIs with others having very much increased. Table 4.4 indicates that MFIs have very much increased in improving loan processing period. The microfinances have moderately increased in opening up new branches as well as acquiring assets. There is very much decrease in anticipation of funding shortfall and changes in liquidity crisis. These firms have also enjoyed improved positive cash flow with 47% of them having very much increased not forgetting the 40% that have moderately increased.

4.5 Firm Characteristic and Organizational Performance

The study examined the relationship between the aspects of firm characteristics and performance. This was determined using Pearson product moment correlation.

4.5.1 Structure Related Firm Characteristic and Organizational Performance

Hypothesis one sought to determine the effect of structure related firm characteristics on organizational performance. Analysis was done using Pearson product moment correlation. The results are presented in Table 4.5

Table 4.5: Structure Related Firm Characteristic and Performance

		structure related	organizational performance
structure related	Pearson Correlation	1	.425**
	Sig. (2-tailed)		.004
	N	45	45
organizational performance	Pearson Correlation	.425**	1
	Sig. (2-tailed)	.004	
	N	45	45

From Table 4.5, the results reveal an r-value of .425 indicating a moderate relationship between structure related firm characteristic and organizational performance. Moreover this relationship is positive. Hypothesis states that a relationship exists between structure-related firm characteristics and performance. The p value (.004) is below .05 thus we accept the alternative hypothesis and conclude that there is sufficient evidence, at 5% level of significance, that there is moderate positive relationship between structure related firm characteristics and organizational performance of MFIs. On the basis of these statistical findings it was found that structure related firm characteristics had significant positive effect on organizational performance of MFIs. The results are consistent with various studies conducted by Usman and Zahid (2011) and Gonzalez (2008) who found that there was positive relationship between structure-related firm characteristics and performance.

4.5.2 Market Related Firm Characteristic and Organizational Performance

Hypothesis two sought to determine the effect of market related firm characteristics on organizational performance. Analysis was done using Pearson product moment correlation. The results are presented in Table 4.6

Table 4.6: Market Related Firm Characteristic and Organizational Performance

		market related	organizational performance
market related	Pearson Correlation	1	.328*
	Sig. (2-tailed)		.028
	N	45	45
organizational performance	Pearson Correlation	.328*	1
	Sig. (2-tailed)	.028	
	N	45	45

Results in Table 4.6 indicate an r-value of .328 indicating moderate relationship between market-related firm characteristics and organizational performance. Moreover this relationship is positive. Hypothesis states that a relationship exists between market-related firm characteristics and performance. The p value (.028) is below .05 thus we accept the alternative hypothesis and conclude that there is sufficient evidence, at 5% level of significance, that there is moderate positive relationship between market related firm characteristics and organizational performance of MFIs. On the basis of these statistical findings it was found that market related firm characteristics have significant positive effect on organizational performance of MFIs. The results support earlier findings by Usman and Zahid (2011), Datta et al., (1991) and Daft (1995) who found that there was positive relationship between market related firm characteristics and organizational performance.

4.5.3 Capital Related Firm Characteristic and Organizational Performance

Hypothesis three sought to determine the effect of capital related firm characteristics on organizational performance. Analysis was done using Pearson product moment correlation. The results are presented in Table 4.7

Table 4.7: Capital Related Firm Characteristic and Organizational Performance

		capital related	organizational performance
capital related	Pearson Correlation	1	.073
	Sig. (2-tailed)		.035
	N	45	45
organizational performance	Pearson Correlation	.073	1
	Sig. (2-tailed)	.035	
	N	45	45

As shown in Table 4.7, we have an r-value of .073 suggesting a weak relationship between capital-related firm characteristics and organizational performance. However this relationship is positive. Hypothesis states that a relationship exists between capital-related firm characteristics and performance. The p value (.035) is below .05 thus we accept the alternative hypothesis and conclude that there is sufficient evidence, at 5% level of significance, that there is weak positive relationship between capital related firm characteristics and organizational performance of MFIs. On the basis of these statistical findings it was found that capital related firm characteristics

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have significant positive effect on organizational performance of MFIs. The findings are consistent with earlier works by McMahon (2001) Kristiansen et.al (2003) who found the existence of a positive relationship between capital related firm characteristics and organizational performance.

4.6   Effect of Firm Characteristics on Organizational Performance

Hypothesis four sought to determine the joint effect of structure related, market related and capital related firm characteristics on organizational performance of the microfinance sector. Regression analysis was conducted between the independent variables and dependent variables in the study. To determine the effect of firm characteristics on organizational performance of micro finances, multiple regression was used to test this hypothesis as presented in Table 4.9 and Table 4.10.

The model summary in Table 4.9 has R value of 0.541 indicating a moderate positive relationship between firm characteristics and organizational performance of microfinances. The R squared value (R^2) is 0.293 indicating that 29.3% variation in the dependent variable (organizational performance) is explained by the independent variables (firm characteristics).

Table 4.9: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.541[a]	0.293	0.241	0.3476

a.   Predictors: (Constant), capital related, structure related, market related

Table 4.10: Full Regression Model

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	T	Sig.
1	(Constant)	3.72	0.698		5.326	0
	structure related	0.314	0.1	0.463	3.155	0.003
	market related	0.454	0.193	0.365	2.353	0.024
	capital related	0.166	0.084	0.326	1.97	0.046

a. Dependent Variable: organizational performance

From the full regression model in Table 4.10, we obtain the regression equation. Using the unstandardized beta coefficiens, the following regression equation was developed.

$$Y = 3.72 + 0.31X_1 + 0.45X_2 + 0.17X_3 + \varepsilon$$

On the basis of the beta and significance values, firm characteristics namely; structure related (β =0.314, P=0.003), market related (β = 0.454, P=0.024), capital related (β =0.166, P=0.046) were found to significantly influence performance of microfinances. This means that the three independent variables contributed significantly to the model and thus the alternative hypothesis that firm characteristics have significant influence on performance of the MFIs in Nakuru was accepted. From the analysis, it is noted that a unit change in structure related firm characteristics had greatest impact on performance of the MFIs while capital related firm characteristics had the least.

The standardized beta coefficients give a measure of the influence of each variable to the model. Regarding the inference of firm characteristics on performance, the study revealed that structure related firm characteristics had a greater influence on performance (Beta = 0.463), followed by market related firm characteristics(Beta = 0.365), finally capital related characteristics had the least inference on performance(Beta = 0.326).

These results are consistent with research findings done earlier by Usman and Zahid (2011), McMahon (2001) and Kristiansen et.al (2003) who established that firm characteristics comprise the basis of determinants of organizational performance. These findings established that the three aspects of firm characteristics are complementary in the sense that they jointly influence performance level of microfinances.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1   Introduction

This chapter presents the summary of findings, conclusion of the study and recommendations of the study for practice and further research.

5.2   Summary of Findings

The objective of this study was to determine the effect of firm characteristics on performance of microfinances in Nakuru. The firm characteristics were classified into three major categories that is structure based, market oriented and capital related firm characteristics. The variables were moderated by organizational structure, environmental factors and strategy. All the dimensions of firm characteristics are strong determinants of the microfinance performance.

This study found that structure-related firm characteristics have a statistically significant and moderate positive effect on performance. The study further found out that market-related firm characteristics have a statistically significant and moderate positive effect on organizational performance. Finally the study established that capital-related firm characteristics have a statistically significant but weak positive effect on organizational performance on firms offering microfinance services.

The general finding of the study is that the three categories of firm characteristics have a joint positive effect on organizational performance firms in the microfinance sector. Firm characteristics namely structure related, market related and capital related were found to significantly influence performance of microfinances. From the finding, among the three dimensions of firm characteristics structure based firm characteristics had the highest effect on organizational performance while capital related firm characteristics had the least effect on organizational performance.

5.3   Conclusion

The general finding of the study confirms that all the three dimension of firm characteristics will have influence on the performance of the microfinance sector. The size and age of microfinances have a positive relationship with performance of microfinance. Microfinances that practise market oriented and diversification

strategies are seen to be better performers than those who practice the contrary. Microfinances with high capital structure are excellent performers in the industry.The study therefore provides a solution to our problem which sought to determine the effect of firm characteristics on organizational performance. From the results it can be concluded that firm characteristics account for 29.3% variation in organizational performance of firms in the microfinance sector.The other remaining percentage could be explained by factors that are out of scope of this study. Conclusively, the results of the study show that firm characteristics have a significant effect on organizational performance of microfinances.

5.4   Recommendations

5.4.1   Recommendations for Practice

The study reveals that there is a positive relationship between firm characteristics and organizational performance of microfinances. From the findings, it is recommended that stakeholders in the microfinance sector should focus most of the resources on establishment of strong background, so that they can reap from their investments. Therefore there should be a continuous effort to enhance awareness and prosperity of firm characteristics since firms collapse, as a result of poor management of resources i.e. firm characteristics. Therefore potential investors should consider large microfinances, established (old) microfinances, market oriented and diversified microfinances as well as MFIs with large capital so to reap maximum returns. From the findings, it can be recommended that MFIs should put in place established resources so as to have competitive advantage in the industry.

5.4.2   Recommendations for Further Research

The study focused on the effect of firm characteristics on performance of microfinance institutions. The findings suggest that organizational performance of MFIs is explained at 30% by firm characteristics. This gives room for further studies to establish other casual relationships. It will be of interest for researchers to map firm characteristics ratings with actual financial performance. A future research can also be done by making an inquisitive study into the financial prowess of the firms. Further enlargement of the scope of study to a larger geographical area would also have a significant increment to the value of this research. Therefore research could be done on MFIs in other regions or a similar study in other sectors.

All the items were equally dealt in the survey. However some aspects of firm characteristics may have more influence on organizational performance than others which may provide misleading results. In other words, future researches can be done with other aspects under control to verify these findings. This will also be of importance in determining factors that may have not been of significant effect in the study. This study focuses on MFIs. Further research can be conducted in other industries to verify if these finding still hold.

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APPENDICES

APPENDIX 1: Letter of introduction

EGERTON
NAKURU TOWN

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UNIVERSITY
CAMPUS COLLEGE

P. O. Box 13357
Nakuru

OFFICE OF THE DEAN
FACULTY OF COMMERCE

30th January 2013

TO WHOM IT MAY CONCERN

RE: RESEARCH UNDERTAKING – MUHINDI ZACHARY KISENGO: CM11/0467/09

This is to certify that the above named person is a bona fide student of Egerton University undertaking Masters in Business Administration programme offered at Nakuru Town Campus College. He has passed all the coursework examinations and the research proposal for the partial fulfilment of the requirement of the degree. The title of his research is *"Effect of firm characteristics on performance of microfinance institutions in Kenya". A case of Nakuru Municipality.*

The purpose of this letter is to request you to allow him to collect data from your organization.

This information and data thus given will only be for research purposes and will be treated with

Utmost confidentiality.

Any assistance accorded to him will be highly appreciated.

Mr PAC Kapsoot
DEAN FACULTY OF COMMERCE

PAC/cnm

Egerton University is ISO 9001: 2008 Certified

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Section A: Organizational Profile

1. Name of Organization: _____

2. Location of MFI_____

3. Position of respondent_____

4. Target groups_____

5. Geographical coverage _____

6. Product/Services offered _____

Section B: Firm Characteristics

Please answer the following questions to describe the characteristics of your organization

Structure Related Firm Characteristics
1. Size of the Firm

   i. Please indicate the number of branches you have in Kenya

          Less than 10   [ ]
          Between 10-20   [ ]
          Between 20-30   [ ]
          Between 30-40   [ ]
          Above 40   [ ]

   ii. What is the net worth of the firm in 000 000's?

          Below 5   [ ]
          5 to 10   [ ]
          10 to 15   [ ]
          15 to 20   [ ]
          Over 20   [ ]

   iii. What is the average loan size in 000's?

          Below 20   [ ]
          20-40   [ ]
          40-60   [ ]
          60-80   [ ]
          Above 80   [ ]

   iv. How many employees do you have?

          Below 100   [ ]
          100-200   [ ]
          200-300   [ ]
          300-400   [ ]
          Above 400   [ ]

2. Ownership

i. What is the MFI's legal structure?
    NGOs   [ ]
    Cooperatives   [ ]
    Credit unions   [ ]
    Nonbank financial institutions   [ ]
    Commercial banks   [ ]

ii. Please indicate the ownership of the institution using the categories below
    Local (75% or more)   [ ]
    Local (51% -75%)   [ ]
    Both foreign and local (50/50)   [ ]
    Foreign (51% -75%)   [ ]
    Foreign (75% or more)   [ ]

iii. Indicate the C.E.Os tenure in office in years
    Below 2   [ ]
    2-4   [ ]
    4-6   [ ]
    6-8   [ ]
    Above 8   [ ]

iv. What percentage of management board comprises professionals?
    Below 20   [ ]
    20-40   [ ]
    40-60   [ ]
    60-80   [ ]
    Above 80   [ ]

3. Age of the Firm

i. Using the categories below please indicate how long your MFI has been in operation.
    Below 10 yrs   [ ]
    10-20 Yrs   [ ]
    21-30 Yrs   [ ]
    31-40 Yrs   [ ]
    Above 41 yrs   [ ]

ii. How many C.E.Os has the firm had since its inception
    Less than 3   [ ]
    Between3-6   [ ]
    Between 6-9   [ ]
    Between 9-12   [ ]
    Above 12   [ ]

Market Related Firm Characteristics
4. Market Orientation

i. What percentage of the loan portfolio do savings fund?
    Below 20   [ ]
    20-40   [ ]
    40-60   [ ]
    60-80   [ ]
    Above 80   [ ]

ii.   Is savings a requirement for borrowing?

           Never   []
           Rarely   [ ]
           Sometimes   [ ]
           Often   [ ]
           Very often   [ ]

iii.   What percentage of outstanding loans is accounted for by forced savings?

           Below 20   [ ]
           20-40   [ ]
           40-60   [ ]
           60-80   [ ]
           Above 80   [ ]

iv.   What is the minimum loan size in 000s?

           Below 5   [ ]
           5-10   [ ]
           10-15   [ ]
           15-20   [ ]
           Above 20   [ ]

v.   Is the product full cost exposed to customers?

           Never   [ ]
           Rarely   [ ]
           Sometimes   [ ]
           Often   [ ]
           Very often   [ ]

5. Firm diversification

i.   How many different products does your MFI have?

           Below 2   [ ]
           2-4   [ ]
           4-6   [ ]
           6-8   [ ]
           Above 8   [ ]

Using the key where; 1= Not at all 2= Little extent 3= Moderate extent 4= Great extent 5= Very great extent, indicate the extent to which the following statement describe your organization.

		1	2	3	4	5
ii	Reliance on a single financial product to drive profitability					
iii	Involvement in other forms of businesses					
iv	Collaboration with other MFIs					
v	Intention/Capacity to introduce other products					
vi	Expansion to other regions					

Capital Related Firm Characteristics
6. Capital
Using the key where; 1= Never 2= Rarely 3= Sometimes 4= Often 5= Very often,
indicate the extent to which the statement describe capital position of the
organization.

		1	2	3	4	5
i	Access financial support from the government or banks					
ii	Dependence on other fixed assets for financial sustainability					

Section C: Performance
Using the key where; 1=very much decreased 2=moderately decreased 3= not
changed 4= moderately increased 5= very much increased, indicate the extent to the
following have changed in your organization in the last three years.

		1	2	3	4	5
i	Number of branches					
ii	Number of clients					
iii	Loans recovered					
iv	Loans volume					
v	Funding from donors					
vi	Financial surplus					
vii	Organizational assets					
viii	Anticipation of funding shortfall					
ix	Experienced liquidity crisis					
x	Experienced a positive cash flow in the past 3 years					
xi	Improved Loan processing period					

APPENDIX 3: Institutions Offering Microfinance Services in Nakuru Municipality (January 2013)

1. African provident limited
2. AAR Credit Services
3. Bank of Africa Kenya limited
4. Bank of Baroda Kenya limited
5. Barclays bank of Kenya limited
6. Blue limited
7. Business initiatives and management
8. C.f.c stanbic bank limited
9. Crater forex bureau limited
10. Credit bank limited
11. Deci capacity building
12. Ebony foundation
13. Equity bank limited
14. Family bank limited
15. Faulu Kenya DTM Limited
16. Fina bank limited
17. First community bank limited
18. Harambee cooperative savings and
19. Housing finance company of Kenya
20. Jamii bora Kenya limited
21. Jitegemea Credit Scheme
22. Jitegemee Trust Limited
23. Kenya business community
24. Kenya commercial bank limited
25. Kenya ecumenical church loan fund
26. Kenya Post Office Savings Bank
27. Kenya women financial trust limited
28. K - rep Bank Ltd
29. Kukopesha limited
30. Kenya Entrepreneur Empowerment Foundation (KEEF)
31. Micro Kenya limited
32. Molyn credit limited
33. Nakuru teachers cooperative
34. Oriental commercial bank limited
35. Pamoja Women Development Programme (PAWDEP)
36. Platinum credit limited
37. Restoration credit Africa limited
38. Rift valley forex bureau limited
39. Savings and loan Kenya limited
40. SISDO Smallholder Irrigation Scheme Development Organisation
41. Small and Micro-Enterprise Programme (SMEP)
42. Tatua investments
43. The agricultural finance
44. The co-operative bank (k) limited
45. The globals limited
46. Tupandane Sacco society
47. Umoja entrepreneur credit(k)
48. Umoja women entrepreneur