

**INFLUENCE OF MICRO-FINANCE INSTITUTIONS ON
TRANSFORMING MICRO, SMALL AND MEDIUM
ENTERPRISES IN KENYA**

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(Business Administration)

**JOMO KENYATTA UNIVERSITY OF
AGRICULTURE AND TECHNOLOGY**

2017

**Influence of Micro-Finance Institutions on Transforming
Micro, Small and Medium Enterprises in Kenya**

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**A Thesis submitted in partial fulfilment for the Degree of
Doctor of Philosophy in Business Administration in the
Jomo Kenyatta University of Agriculture and Technology**

2017

DECLARATION

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

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DEDICATION

This PhD thesis is dedicated to my beloved late wife Carren Momanyi and my children, Vera, Victor, Rebecca and Ruth.

ACKNOWLEDGEMENT

First, I wish to sincerely thank my loving children for their endurance over the many days I have spent both in school and in the field conducting my consultancy work so that I can improve our family life.

In a very profound way, I wish to sincerely thank Prof. Roselyn Gakure and Dr. George Orwa and Dr. Wario Guyo for their tireless efforts in supporting me throughout my thesis research. Their guidance and professional input was invaluable. I also extend my gratitude to Dr. Victor Keraro and several other good friends who provided professional guidance, advice and encouragement that led to the completion of my thesis. I am truly grateful for the guidance received from these distinguished scholars who have made me come this far.

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LIST OF ACRONYMS AND ABBREVIATIONS

ADAF	Appropriate Development for Africa
AMFI	Association of Micro Finance Institution
ANOVA	Analysis of Variance
CGAP	Consultative Group to Assist the Poor
EBRD	European Bank for Reconstruction and Development
FINCA	Foundation for International Community Assistance
HRD	Human Resources Development
HRM	Human Resources Management
IFC	International Finance Corporation
IMF	International Monetary Fund
JKUAT	Jomo Kenyatta University of Agriculture and Technology
KIPPRA	Kenya Institute for Public Policy Research and Analysis
MFI	Micro Finance Institution
MSMEs	Micro, Small and Medium Enterprises
ROSCAS	Rotating Savings and Credit Association
SACCO	Savings and Credit Co-Operative
SPSS	Statistical Package for Social Sciences
SASRA	Sacco Societies Regulatory Authority
WB	The World Bank

DEFINITION OF KEY TERMS

Financial Performance: This is a measure of how well firm use assets from its primary mode of business to generate revenues (Bruett, 2005; Cull, Demiguc-Kunt & Morduch, 20070). It measures the financial health of an organization. The common indicators of financial performance are; profits, return on investment, return on assets, value added and margins among others. Financial performance guides management on the strategies and policies to adopt to improve sustainability of the organization (Bruett, 2005).

Micro-Finance Institution (MFI): A microfinance institution is an organization that offers financial services to low income populations (Aghion & Morduch, 2005; CGAP, 2003; Hermes & Lensink, 2011). Almost all give loans to their members, and many offer insurance, deposit and other services. A great scale of organizations is regarded as microfinance institutes.

Micro, Small and Medium Enterprises (MSME): Definitions of MSME vary across countries. In Sub-Saharan Africa, they are generally defined as enterprises that employ between one and 100 employees, and have an annual turnover of up to Kshs.100 million (US\$1,300,000) (EBRD, 2006; Taiwo, 2012). The critical social and economic importance of MSMEs is undeniable. Throughout the world they are considered to be the backbone of healthy economies. Their growth is a fundamental component of economic development. In many countries, they comprise more than 40 percent of businesses and generally serve as the largest engine of

job growth in developing and transition economies, often accounting for 20–90% of employment.

Small and Medium Enterprises (SME): The Kenyan definition of SMEs in terms of employment consists of: Micro enterprises – from 0 to 9 employees; Small enterprises – from 10 to 49 employees; Medium enterprises – from 50 to 149 employees; and large enterprises – from 150 and over while the Sessional Paper set a limit of 50 workers for the small-medium enterprises in Kenya (GOK, 2006 and 2008).

Transformation: Transformation is the creation and change of a whole new form, function or structure (Senge, 1990 and 1999; Deming, 1986; Daszko & Sheinberg, 2005). To transform is to create something new that has never existed before and could not be predicted from the past. Transformation is a “change” in mindset (Senge, 199). It is based on learning a system of profound knowledge and taking actions based on leading with knowledge and courage. Transformation occurs when leaders create a vision for transformation and a system to continually question and challenge beliefs, assumptions, patterns, habits and paradigms with an aim of continually developing and applying management theory, through the lens of the system of profound knowledge. Transformation happens when people managing a system focus on creating a new future that has never existed before, and based on continual learning and a new mindset, take different actions than they would have taken in the past (Russel, 1981; Kotter, 1995).

ABSTRACT

Micro-financing has over the recent past gained prominence among the developing countries of Asia, Latin America, Eastern Europe and Africa as a financial solution to challenges faced by micro, small and medium sized enterprises. The growth and prominence of micro-financing has been propelled by the intensive search for solutions to poverty alleviation. The general objective of this study was to establish the influence of Microfinance Institutions in transforming micro, small and medium enterprises in Kenya. The study relied on a positivist research philosophy and used a cross-sectional research design, in the form of a survey. The population of the study was 45 micro finance institutions registered as members of AMFI Kenya. Stratified random sampling was used in this study with a sample size of 135 respondents. Respondents were grouped into three strata; top management, middle management and supervisory employees. Pilot testing was done equivalent to 10% of the sample size from MFIs other than those involved in the study. Primary data collected using questionnaires was used in the study. Data was analyzed and presented using the Statistical Package for Social Sciences (SPSS).. Information was sorted, coded and input into the statistical package for social sciences (SPSS) for production of graphs, tables, descriptive statistics and inferential statistics. Spreadsheets were also used to supplement SPSS results. The study established that, taken together, three out of the five predictor variables contributed the most to the total variability in the transformation of MSMEs. The three predictor variables are; institutional policies, management functions and effective financial management systems. The study findings revealed that MFIs have a significant transformative influence on MSMEs through the establishment of effective institutional policies aimed at improving business climate in which MSMEs operate. A critical priority of the MFIs is thus to develop a regulatory and business environment that removes impediments to accessing and providing financial support to the MSMEs. To address the challenges of changing customer needs and tastes, MFIs should ensure that policy and regulatory instruments applied on MSMEs clients are developed upon empirical data that clearly shows market trends. Instituting proper managerial structures and processes in MFI operations was also found critical in transforming the operations of MSMEs. Effective management structures and processes were found to permit institutions to attenuate and amplify talent that is critical for organizational stability and support to the MSMEs. The study further revealed that strong communications systems within MFI organizations are critical for the transformation of MSMEs. In additions, MFIs should develop strong financial bases with good revenue streams for them to be of transformative support to MSMEs. Strong MFI liquidity position, with adequate cash flows assist in addressing the borrowing needs of MSMEs supported.

To enjoy good revenue streams and attain adequate cash flow positions, MFIs should possess excellent financial management skills which will have extended effects in the transformation of MSMEs clients. Management of credit periods on loans offered to MSME significantly enable MSMEs to attain desired transformative positions. These findings will benefit policy makers, MFI Finance Managers, Credit Officers, as well as officials in leadership and governance in terms of developing effective policy to regulate MFIs operations in a bid to transform the ever increasing number of MSMEs in Kenya. These results will also benefit scholars, researchers and students in terms of opening up a new frontier of information that will enhance their understanding of this important and steadily growing thematic of MSMEs and micro-financing in Kenya. The study makes two recommendations for further studies.

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

1.1.1 Global Perspective of Influence of MFIs on Transformation of MSMEs

Micro-finance institutions are considered to be making a significant contribution in the provision of financial and non financial services to the Micro, small and medium enterprises (MSMEs) sector. This sector is increasingly seen as playing an important role in the economies of many countries. Governments throughout the world focus on the development of the MSME sector to promote economic growth. In South Africa, MSMEs contribute 56% of private sector employment and 36% of the gross domestic product (Ntsika, 2002). South Africa, like the rest of Sub-Saharan Africa suffers from high unemployment with an official estimate of approximately 24.5% of the economically active population unemployed as published in the Statistics South Africa's Quarterly Labour Force Survey of 2009. Mahadea (2008) argued that the contribution of the MSME sector cannot be sustained without the creation and support of new MSMEs.

The survival rate of SMEs (small and medium enterprises) is relatively low, according to Ligthelm and Cant (2002). The authors argue that less than half of newly established businesses survive beyond five years. This is not only true for South Africa, but also a common phenomenon in the rest of the world. In the South African economy, more than one million jobs have been shed since 1990, bringing the unemployment rate, by February 2002, at 28 percent. The SME sector is widely regarded as the driving force in economic growth and job creation in both developed and developing countries (Sunter, 2000). The important contribution that SMEs can make to employment and income generation is recognized around the world, and in particular in South Africa.

According to Brink, Cant and Ligthelm (2003), it is estimated that the failure rate of micro, small, medium and micro enterprises (MSMEs) is between 70% and 80%. In a paper presented at the 16th annual conference on Small Enterprise Association in

Australia and New Zealand, Brink, Cant and Ligthelm (2003) observed that millions of Rands (local South African currency) are being lost on business ventures because of essentially avoidable mistakes and problems. They contend that often the ideas are good and the people behind them are competent, but “they do not have a clue of how to run a business” and have no underlying appreciation of business fundamentals. These scholars state that the problems encountered by small businesses are numerous and can be described amongst others as being environmental, financial or managerial in nature.

Micro, Small and Medium Enterprises (MSMESs) across Africa face many and varied challenges to their growth and operations (Wanjohi, 2008 & 2009; UNIDO, 2002). These challenges include: inadequate office space, poor infrastructures such as electricity and water services, expensive internet connectivity, inflexible lease terms and poor human skills. The authors contend most of the MSMEs are also located in un-attractive locations, thus projecting a negative image to potential customers. A study by Wanjohi (2009) and Ndagu and Obuobi (2010) revealed that often such organizations operate from garage floors of a house, or are located in a crowded market area. Njagi (2011) contends that image is important for an aspiring MSME that is trying to establish its credibility, especially one that has just a few employees and is seeking to get service contracts from larger corporations.

Ryne and Otero (2006) argue that most MSMEs are launched by aspiring entrepreneurs who have had no previous experience, possibly even little exposure to a mature corporate environment. These scholars further argue that the enterprises are not planned appropriately, markets are not assessed, products not commercialized, marketing not adequate or imaginative, and good corporate governance frequently lacking. Other challenges faced by MSMEs which affect their growth and profitability, thus diminishing their ability to contribute effectively to sustainable development include: a weak and underdeveloped business environment, complex entry regulations, tedious red tape registration and certification processes, high incidences of corruption, lack of credit, inadequate business skills and infliction of pandemic diseases such as HIV/Aids. These challenges provide few incentives to MSMEs to become (or remain) active in the formal part of the economy. There is a major crisis across Africa (Ndagu & Obuobi, 2010; Owualah, 2007; Otero, 1999;

Kereta, 2007) that is also fuelled by the nature of a tight labour market and few good opportunities for employment for the annual graduating students where they can watch and learn best practices. These authors contend that individual entrepreneurs have: little access to financial products and services, little training in project management and scheduling, and are unaware of basic business practices like feasibility studies. For these and many other reasons discussed above, in many of these countries, a large share of MSMEs is not participating in the formal economic development.

The key concern of micro-financing institutions is the provision of high-quality and affordable financial and non financial services such as savings, credit, insurance, payments, and money transfers to low-income people to enable them finance income-generating activities, build assets, stabilize consumption, and protect themselves against risks (Banerjee, Duflo, Glennerster & Kinnan, 2009). Micro-financing is not a new concept; it dates back to the 19th century when money lenders were informally performing the role of the current banking institutions. The informal financial institutions which included village banks, cooperative credit unions, and social venture capital funds helped provide the poor with savings and credit services to finance their micro, small and medium enterprises. They mobilized savings based on established and accepted procedures by the low income clients (Coleman, 2006).

Over the period between 1985 and 2005, there has been growing enthusiasm for promoting micro-financing as a strategy for poverty alleviation (Coleman, 2006; Hermes & Lensik, 2011; Yunus, 2007). These authors further contend that the micro-finance sector has blossomed in many countries, leading to multiple financial services firms serving the needs of micro entrepreneurs and poor households and also led to the formation of the Grameen Bank in Bangladesh in 1983. Micro financing has gained prominence (Sengupta & Aubuchon, 2008) among poor and developing countries of Asia, Latin America, Eastern Europe and Africa. According to these scholars, the growth and prominence of micro-financing has been propelled and influenced by the intensive search for solutions to poverty alleviation. Micro-financing is now accepted to be the provision of a full range of financial services which include: savings, credit, micro leasing and micro insurance to low-income earners (Littlefield, Morduch & Hashemi, 2008).

Bank Rakyat Indonesia (BRI), another flagship of the micro-financing movement in the form of village banking unit system the largest micro-financing institution and state-owned bank in developing countries was also formed in 1980s. It currently serves over 22 million micro savers through autonomously managed micro-banks (Mallick, 2011; Rhyne & Otero, 2006; Otero, 1999). A study by CGAP (2008) revealed that institutions offering micro-finance services in recent years have grown both in outreach and asset base raising safety concerns on such micro-finance operations. Many countries have opted to regulate these operations at varying degrees (CGAP, 2008). The CGAP (2003) defines regulation as binding rules governing the conduct of legal entities and individuals, whether they are adopted by a legislative body or an executive body. Two forms of regulations exist, namely: prudential and non-prudential. Institutions that mobilize deposits threaten the security of the financial sector and pose a risk to depositors hence require prudential regulation (CGAP, 2003). Institutions that meet the prudential regulation are then issued with an operating license to carry out the financial service delivery as per the set rules (CGAP, 2003).

The unmet financial needs and the apparent gap of lack of financial services facing the poor in the world led to establishment of micro financial institutions (MFIs) to meet the market niche of SMEs. Lauer (2008) noted that MFIs arose in the 1980s as a response to doubts and research findings about state delivery of subsidized credit to poor farmers. This was pioneered by the Nobel Prize winner, Prof. Mohammed Yunus with his innovative Grameen Bank of Bangladesh Model. Subsequently, the last two decades have witnessed the mushrooming of MFIs yet the financial needs of SMEs especially agricultural related (farming, agribusiness, livestock) remain unresolved.

1.1.2 Local Perspective of Influence of MFIs on Transformation of MSMEs

Nyanjwa (2008) reported that the key umbrella MFI organizations in Kenya namely: the Association of Microfinance Institutions (AMFI), in Kenya boasted of 25 MFIs, 4 wholesalers, 59 Financial Services Associations (FSAs) and 40 MFIs respectively by end of 2005, totalling to 128 institutions. Despite the above expansion of the MFIs as an alternative source of finance, SMEs still face the problem of finance.

Micro-financing gives people the means to secure finances so as to exploit emerging opportunities and make them responsible for their own future. It broadens the horizons and thus plays both economic and social roles by improving the living conditions of the people (Khandker, 2005; WB; 2012 & 2013). These improvements are assessed from the perspective of the development and growth of Micro, Small and Medium size Enterprises. Institutions that have opted to operate under prudential regulations are, in most cases, required to transform institutionally so as to comply with set requirements (Sengupta & Aubuchon, 2008). The scholars aver that in most cases this transformation has involved change of legal status, ownership, organizational structures, systems and their delivery channels. This change has led to some of the challenges facing MFIs in transforming micro, small and medium enterprises to viable businesses in Kenya (Njihia, 2005).

1.2 Statement of the Problem

Kenya's financial sector has undergone several reforms since the late 1990s with the aim of improving profitability, efficiency and productivity of commercial Banks and other financial institutions as a platform for supporting MSMEs. Commercial banks had left a substantial gap in service delivery to financial service users particularly low income earners and MSMEs. Microfinance Institutions (MFIs) among other financial institutions stepped in to fill the gap and have registered remarkable growth over the last two decades as the unbanked population expanded and started patronizing their services. The MFIs are viewed predominantly as instruments of social change and their performance is often measured by non-financial parameters.

The implementation of the Microfinance Act, 2006 by the Central Bank of Kenya and the SACCO Act 2008 by SASRA, as the regulators of the MFIs and SACCOs, respectively has had a great impact on the operations of the MFIs. To transform micro, small and medium enterprises into viable businesses in the dynamic financial market in Kenya is a huge challenge. The need for steady growth and survival for these institutions by shareholders, government, regulatory authorities and stakeholders has resulted in the expansion of the SACCOs and MFIs in the last 10 years. Much of the literature in this area addresses: the social worth of micro-financing organizations (Bruett, 2005), the impact of village level MFIs (Menkhoff

& Rungruxsirivorn, 2011; Kaboski & Townsend, 2005 & 2011), the impact of microcredit on the poor (Karlan & Zinman, 2010), costs and benefits of subsidies in micro-financing and mission drift.

There is evidence (Cull, Demirgüç-Kunt & Morduch, 2007) that raising interest rates results in increased profitability for individual based lending MFIs whereas for solidarity based lenders, the reverse is true. The study by Cull *et al.* (2007) found evidence that raising interest rates leads to improved financial performance and profitability with lower subsidy dependence and higher operational self-sufficiency. Pankaj and Sinha (2010) concluded that most of the best performing firms are following different business models in India. Ahlin and Maio (2011) examined the determinants of performance of MFIs with variables, such as self-sufficiency, borrower growth or loan-size growths estimated by macroeconomic variables as well as macro-institutional factors, such as corruption control.

Locally, Njagi (2011) investigated factors affecting performance of micro-finance institutions in Embu district and concluded that the key reasons behind low performance of MFIs included limited financial resources, loan defaults by recipients, poor management information systems and poor research and development. As demonstrated by the cited empirical studies, there have been a number of studies focusing on the performance of MFIs. However, there exists limited empirical information that details out the problems hindering micro-financing institutions in transforming micro, small and medium enterprises into viable businesses in Kenya, a gap that this study has addressed.

1.3 Objectives

1.3.1 General Objective

The main objective of this study was to determine the influence of Microfinance Institutions in transforming Micro, Small and Medium Enterprises in Kenya.

1.3.2 Specific Objectives

The specific objectives of this study were to;

1. Determine whether MFIs' institutional policies play a role in transforming Micro, Small and Medium Enterprises in Kenya.
2. Investigate the influence of MFIs' management functions in transforming Micro, Small and Medium Enterprises in Kenya.
3. Establish whether MFIs' human resource management contributes to transforming Micro, Small and Medium Enterprises in Kenya.
4. Examine whether governance of MFIs has influence in transforming Micro, Small and Medium Enterprises in Kenya.
5. Ascertain the influence of MFIs' financial management systems in transforming Micro, Small and Medium Enterprises in Kenya.

1.4 Research Hypotheses

The specific objectives of this study were to;

H₀₁: MFIs' Institutional Policies have no significant influence on transforming Micro, Small and Medium Enterprises in Kenya.

H₀₂: MFIs' Management functions have no significant influence on transforming Micro, Small and Medium Enterprises in Kenya.

H₀₃: MFIs' Human resource management has no significant contribution to transforming Micro, Small and Medium Enterprises in Kenya.

H₀₄: Governance of MFIs has no influence on transforming Micro, Small and Medium Enterprises in Kenya.

H₀₅: Financial management systems of MFIs have no role on transforming Micro, Small and Medium Enterprises in Kenya.

1.5 Significance of the Study

The results of this study will inform managers of micro, small and medium enterprises on how to assess and evaluate potential viable MSMEs and how they should be implemented. The results will also provide them an insight into the potential challenges in implementing them. The study results will also assist the credit officers of MFIs to advise potential borrowers on how and where to invest in order to benefit from the loans and also reduce on the failure rate that creates bad debts to MFIs.

The individuals who are seeking projects to invest in can also use this information to assess their viability potential. The results if this study can also help them in their investment appraisals. The information reveals other factors that are responsible for the successes or failures of MFIs. The government will use the findings from this study to facilitate policy formulation and development of a framework for supporting the establishment, expansion and performance of MSMEs.

Findings from this study will assist academicians to broaden their knowledge, insights understanding of the critical factors that affect the performance of MSMEs and the influence of MFIs in transforming MSMEs into viable businesses in Kenya.

1.6 Scope of the Study

This study focused on 45 registered MFIs in Kenya. The study targeted top management, middle management and supervisory employees in the 45 microfinance institutions. The collection of data for this study was done between February and April 2016.

1.7 Study Limitations

The main limitation faced by this study was that a few of the administrators of the targeted institutions considered some of the information sought sensitive and feared that this could reveal their strategies to competitors. This limitation was managed by

making clarifications and assurance that the purpose of the study was purely for academic purposes and not motivated by any other interests whatsoever. Previous studies have been done in the area of MFIs influence of Microfinance Institutions in transforming Micro, Small and Medium Enterprises in Kenya. This meant that there was scanty or limited empirical literature on the specific area locally. This limitation was mitigated by the study diving deeper to find similar studies done in other countries while maintaining focus on the primary variables of the study. The study was also limited by time. In order to deal with the challenge of time, leave was sought from and granted by the researcher's employer which provided more time to focus on the study. The study further engaged research assistants who were well trained and were used to hand deliver and pick the questionnaires and this resulted to a good response rate. Lastly, the study experienced a limitation that was conceptual and theoretical in nature in that some (about 25%) of the respondents took time to conceptualize fundamental research questions on which the study was anchored. Of particular concern to a number of respondents was the relationships between the MFIs and MSMEs as well as the choice of variables and constructs used in the research questions to seek for information. In addressing this limitation, the Researcher and the Research Assistants spared time to explain the basis of the research and the choice of the variables and constructs and how all these were linked. The explanations offered were much appreciated and paved way for useful responses that helped accomplish the study objectives. These few challenges and limitations encountered by the study did not, to any significant extent, negatively impact on the study findings given the measures taken to mitigate them.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

The chapter explores the literature that focuses on the influence of MFIs in transforming micro, small and medium enterprises in Kenya. The chapter commences by reviewing the theories that inform the study. It then reviews the literature from empirical studies that discusses the links between influence of MFIs and the growth of Micro, Small and Medium Enterprises.

2.2 Micro-Financing in Kenya

Micro-financing in East Africa has become a hotbed of innovation in financial services (Njihia, 2005). Kenya is fast catching up with South Africa to become the country with the most comprehensive provision of financial services on the continent (WB, 2012). The WB further notes that the business models of champions such as Equity Bank and M-PESA in Kenya have been studied worldwide as a testimony of innovation (WB, 2012). The Kenyan financial sector is broad and well developed in sub-Saharan Africa. The sector is roughly twice as large as Uganda's and Tanzania's, but all the three countries have tremendous growth potential when compared to developed-country financial sectors (WB, 2012; Njihia, 2005). Kenya has 43 commercial banks and boasts of the best developed micro-financing sector in sub-Saharan Africa. Roughly, three-quarters of the East African micro-financing sector is dominated by Kenya. Kenya is also home to Equity Bank, a former building society considered insolvent in 1993 and is today one of the world's most admired retail banks. Another notable institution is the Kenya Women Finance Trust (KWFT), Africa's largest institution targeting women only, with over 250,000 active borrowers and a fast growing number of savers after successful application for a deposit-taking license (WB, 2013). The Key players in the Kenyan Micro-financing sector include Regulated MFIs: Commercial Banks, Non-Bank Financial Institutions (Post Bank) and the to-be-regulated, transforming MFIs under MFI Act; Non-regulated, credit only MFIs financial wholesalers; Insurance companies (micro-insurance providers) and Capacity development institutions (WB, 2012).

Uganda has 24 commercial banks, of which two (Centenary Bank and Equity Bank Uganda) have a micro-financing focus. In addition, the country has five deposit-taking MFIs and a few smaller MFIs. Among the larger financial institutions, only the two mentioned banks and the deposit-taking MFIs are not concentrated in Kampala. The micro-financing sector in Uganda is regulated by the Bank of Uganda. The use of a credit bureau for both positive and negative reporting is mandatory for all major MFIs. Bio-metric data is used for identification, as Uganda does not have a national ID system (WB, 2012).

Tanzania has 50 commercial banks, but less than a dozen major MFIs. Unfortunately, the large number of commercial banks does not reflect a high degree of financial inclusion. Most Commercial banks have a narrow, often government and commodity sector-related business focus and do not serve a substantial number of households or businesses. While the MFIs focus on the latter segment, together they still reach a relatively small number of 300,000 active borrowers and 390,000 savers. The leading MFI, with 100,000 active borrowers, is Arusha-based Pride. As the MFIs slowly fill the immense gaps in financial inclusion, new entrants to the market, such as Access Bank and Equity Bank bring a new dynamic. In order to access Tanzania's vast and barely tapped rural areas, more effort to keep pace with the fast evolution in Kenya is needed (IFC, 2013).

Apart from the MFIs discussed previously, semi-formal providers such as savings and credit cooperatives (SACCOs) or informal providers such as savings and credit associations (ROSCAs and ASCAs), unlicensed money lenders, or family and friends thus play an important role, particularly in rural areas. Micro-financing as a financial-sector development pursues the objective of a sound financial sector, consisting of a multitude of formal providers competing for clients from all segments of society. The evolution towards financial inclusion is driven by MFIs who combine the credit cooperatives' willingness to serve poor people with the commercial banks' capacity and professionalism. East Africa is one of the world regions where MFIs have proven that they can handle deposits and grow into full-fledged financial providers. In Kenya, the successful transformation of eight credit-only MFIs into deposit-taking MFIs is a strong signal by the sector (Njihia, 2005). The rapid advancement of financial-sector development in East Africa is a powerful testimony

to the important role micro-financing continues to play in emerging economies. The financial sector enables the growth of other industries, and its micro-financing segment caters to a large number of self-employed entrepreneurs, small businesses, and low-income households.

Kenya has a population of 38.8 million according to the 2009 population census released in 2010. The gross national income per capita is estimated at US \$ 1560 and about 18.1 million (46%) people live below poverty line (WB, 2011). The Agriculture sector contributes 24% to the GDP and another 27% indirectly through linkages with other sectors. An estimated 60% of all the households are engaged in farming activity. The food component constitutes over 50% of the overall inflation, meaning that stable food supply is critical to macroeconomic stability (KIPPRA, 2013).

Majority of the population in Kenya live in the rural areas and they are involved in informal activities which includes micro, small and medium enterprises (MSMEs). However, these businesses remain at the micro level with dismal prospects of growth. MSMEs face various challenges which hinder their transformation to viable businesses. Robinson (2006) identified lack of finance as one of the major challenges which the Micro-financing institutions are trying to address. It is therefore expected that the micro-financing industry will play a pivotal role in deepening financial markets and enhancing access to financial services and products by majority of the Kenyans to grow their MSMEs.

The Kenyan Financial Sector has undergone numerous challenges and transformations during its relatively short span of its existence. Microfinance Institutions have opted to transform and expand the variety of their financial products to outreach more clients while Co-operative Societies have been noted to depart from traditionally being savings and credit institutions to institutions that offer front office services that have been a preserve of commercial banks and other financial institutions (SASRA, 2011). According to Kenya Union of Savings and Co-operatives, Savings and Co-operative Societies movement in Kenya is billed as the largest in Africa and among the top 10 globally. With over Kshs 230 billion in assets and a savings portfolio estimated at Kshs 190 billion, the SACCO movement in

Kenya constitutes a significant proportion, about 20%, of the country's domestic savings (SASRA, 2011).

Innovative forms of micro-financing and progressive government policies, as detailed in the Microfinance Act of 2006 have helped to make Kenya's micro-financing sector one of the most developed in Sub-Saharan Africa. The Microfinance Act of 2006 and the Deposit Taking Institutions Regulations 2008 set out the legal, regulatory and supervisory framework for the micro-financing industry in Kenya. Among the reasons why MFIs have transformed and diversified into deposit taking institutions is accelerated growth, enhanced profitability, diversification of risk, reduction of tax liability, financial benefits and increased market power (Gaiha & Nandhi, 2006; Dalla Pellegrina, 2011; Besley, 1994). On the other hand, MFIs are developing a variety of customized products and services to outreach more clients and provide financial access to MSMEs. The push for Micro-financing regulation in Kenya has come from the Association of Micro-financing Institution (AMFI), the umbrella body of MFIs in Kenya which has been lobbying for the regulation for the last ten years to gain access to local deposits. Access to local deposits in form of savings is regarded as a cheap source for MFIs for on-lending (Rosengard, Rai, Dondo & Oketch, 2001). With dwindling availability of donor grants and expensive commercial loans, MFIs have found themselves constrained in their expansion plans.

The Kenyan government has been concerned about the need to protect the poor against losses that could be occasioned by unscrupulous operators. According to Wanjohi (2009), the poor are more vulnerable to slip into extreme poverty than the rich. In a span of two years, between 2005 and 2007, Kenya experienced two financial scandals targeting the poor under the pretext of being a micro-financing and savings scheme. This has prompted the central bank to restrict use of the word 'finance' business names to those that are regulated by it. The regulation of micro-financing in Kenya has adopted a three-tier approach: Prudential regulation and supervision for deposit-taking institutions by central bank, non-prudential regulation for credit only by ministry of finance and no regulation for ROSCAs and ASCAs.

2.3 Theoretical Literature

This section reviews theoretical foundations that discuss and explain MFIs behavior. The theories assisted in appreciating how the MFIs affect the transformation of micro, small and medium enterprises to viable business in Kenya. The theories discussed are the financial growth theory, pecking order theory, contract theory and Resource Based (View Theory RBV) and all these theories, as discussed in sections 2.3.1 to 2.3.4 have direct relevance and impact to this study on MFIs and MSMEs.

2.3.1 Financial Growth Theory

Berger and Udell (1998) propose a financial growth theory for small businesses where the financial needs and financing options change as the business grows, becomes more experienced and less informationally opaque. They further suggest that firms lie on a size/age/information continuum where the smaller/younger/more opaque firms lie near the left end of the continuum indicating that they must rely on initial insider finance, trade credit and/or angel finance. The growth cycle model predicts that as a firm grows, it will gain access to venture capital (VC) as a source of intermediate equity and mid-term loans as a source of intermediate debt. At the final stage of the growth paradigm, as the firm becomes older, more experienced and more informationally transparent, it will likely gain access to public equity (PE) or long-term debt.

This theory is relevant to this study as MFIs are financing outfits and they mainly finance small businesses such as the MSMEs. The finance theory, therefore, just as is the case with the rest of the other theories are directly relevant to the inter-relationships and operations of the MFIs and the MSMEs. It brings out the fact that as the MSMEs becomes older, more experienced and more informationally transparent, it takes the option of accessing financing from public equity (PE) or long-term debt.

Problems related to financing are dominant in the literature with regard to small firms. There are numerous empirical studies describing inadequate financing as the primary cause of MSMEs failure (Jones, 1979; Wucinich, 1979; Welsh & White, 1981; Gaskil & Van Auken, 1993; Van Auken & Neeley, 1996; Coleman, 2000;

Owualah, 2007). The capital structure of small firms differs significantly from larger firms because small firms rely more on informal financial market which limits the type of financing they can receive. The small firm's initial use of internal financing creates a unique situation in which capital structure decisions are made based on limited financing options. It is widely accepted that small firms have different optimal capital structures and are financed by various sources at different stages of their organizational lives (Berger & Udell, 1998). Researchers have found that certain attributes of small firms influence the type of funds available to finance the firm's operations (Van Auken & Neeley, 1996; Hall *et al.*, 2000; Romano *et al.*, 2001).

2.3.2 Pecking Order Theory

Another financing theory that is very familiar with the operations of the small business and is directly relevant to the operations of MFIs and MSMEs, is the pecking order theory, proposed by Besley (1994) and Aghion and Morduch (2005). It sheds light on the incentives that drive MSMEs' capital structure decisions. This theory proposes that firms, including the small ones such as MSMEs, prefer to use internal sources of capital first and will resort to external sources only if internal sources are inadequate. This theory has been found to be relevant to the financing of SMEs. Most SMEs start with internal financing before looking for external sources. Older firms, by definition, have had more opportunities to accumulate retained earnings than younger companies and thus more funds are available to finance operational growth. Pecking order theory suggests that those funds should be used before external capital sources are tapped. Holmes and Kent (1991) found that small businesses experience a more intense version of pecking order in their decisions because access to appropriate external sources of capital is limited. It has been noted that small businesses differ in their capital structure but their intense reliance on pecking order is only one of the variables that make small businesses financing decision unique. Small businesses rely on private capital markets, while larger firms are financed through public market. Information on small businesses is much less readily available than information on larger firms which can be picked up in the annual reports.

Small businesses reliance on private markets limits the types of financing that they can receive; most small businesses rely on commercial banks and finance companies to provide capital (Berger & Udell, 1998). In most cases, the cost of capital for small businesses is usually higher than it is for larger firms. The size of the loan and lack of information on the quality of operation of the small firms force lenders to protect their investment by demanding higher rates of return, which come in the form of high interest rate and high cost of capital for the small firm. In an attempt to avoid higher cost of capital, smaller firms are then forced to use more short-term debt, which carries lower costs but raises the firm's risk (Chittenden *et al.*, 1996). When loaning to small businesses, most financial institutions require the owners of the small businesses to personally guarantee the loan. These personal guarantees allow the institution recourse against the personal wealth of the small businesses owner in the event of default (Berger & Udell, 1998). These restrictions on the type of finance available to SMEs coupled with the small firm's insistence on first using internal sources of capital (Holmes & Kent, 1991), creates a unique structure for small business. Romano *et al.* (2001) describe the situation as a complex array of factors that influence small –to – medium size enterprises (SME) owner-manager's financing decisions''. This is supported by Hall *et al.* (2000) who found that firm's size is positively related to long-term debt and negatively related to short-term debt. In further support, Chittenden *et al.* (1996) suggest that a firm's size is correlated with the firm's reliance on pecking order theory in capital structure decisions. Thus, smaller firms are more likely to rely on internal funds. Romano *et al.* (2001) found a significant relationship between the size of the firm and the use of debt. Again, these results are consistent with pecking order theory and the Berger and Udell (1998) model. Availability of information is another factor that limits the financing ability of the small firm. Small firms often do not have audited financial statements. Larger firms, on the other hand, must disclose a large amount of information about their financial standing on a systematic basis. As a result of this information void, the investor in small firms is unable to distinguish between high- quality and low-quality companies and therefore raises the firm's cost of funding to compensate for risk. The investor will require a high rate of return in exchange for investing in a firm without all of the proper information. The investor requires this higher rate of return because the information is not available to establish the extent to which the small firm is

likely to default. This actually limits small firms in accessing external fund (Ahlin & Lin, 2006; Weinberg, 1994).

2.3.3 Contract Theory

In contract theory, asymmetric information arises when one of two parties engaged in a business transaction happens to have more or different information than the other. In such a situation, one party often does not know enough about the other party and fails to make an accurate decision, as is often the case between MFIs and MSMEs. This circumstance leads to a potential adverse selection and moral hazard problems in the credit market. Adverse selection is a problem arising from asymmetric information which occurs before a transaction is entered into. A lender may decide not to lend money although the borrower is worthy of the loan and has the potential to make loan repayments as expected. Moral hazard is a problem of asymmetric information that arises after transition has occurred. The borrower might engage in activities that are undesirable from the lender's point of view, and this makes it less likely that the loan will be paid back. For these reasons, formal financial institutions insist on collaterals as a prerequisite for providing loan money to small enterprises. The disbursement of loan money without securing adequate collateral is considered too risky, and this is a fact that affects a lot of small businesses such as MSMEs. Banerjee and Duflo (2010) and Banerjee, Duflo, Glennerster and Kinnan (2009) have pointed out that information asymmetry is one major cause of credit constraint in small businesses and enterprises. According to the authors, capital does not always flow to small firms because of adverse selection and moral hazard, two factors that are known to have a devastating negative impact on small enterprises.

2.3.4 Resource Based View Theory (RBV)

According to the RBV of the organization, a strategic business unit (SBU) has competencies that may improve performance. In order to take full advantage of such resources, however, the SBU must possess capabilities, defined as bundles of skills and knowledge, so that the SBU can deploy its competencies and coordinate its activities in such a way as to create sustainable competitive advantage (Barney, 1991; Day, 1990; Desarbo *et al.*, 2007). Capabilities are defined extensively as complex

bundles of skills and accumulated knowledge that enables organizations (or SBUs) to coordinate activities and make use of their assets (Day, 1990). Capabilities reflect techniques of organization and knowledge capacity especially with regard to individuals, teams and level of the organization. Day (1990) suggest that it is not possible to enumerate all possible capabilities, because every business develops its own configuration of capabilities that is rooted in the realities of its competitive market, past commitments, and anticipated requirements.

In recent investigations (Jimenez *at al.*, 2008; O'Cass & Viet, 2007; Langerak, 2003; Hurley & Hult, 1998) three organizational characteristics has been emphasized as factors influencing performance, which are market orientation, innovative culture and organizational learning. Market orientation is recalled as one of the most important capabilities of market. It is believed that innovative culture is essential to competition in the third millennium which looks for new opportunities inherently with its concentration on entrepreneurship, innovation and adaptability. Also, organizational learning is considered as one of the key characteristics of the organization which has a considerable influence on organizational performance and is necessary for customers in creating of organizational innovation and innovative development of unique ways in order to deliver value.

According to Barney (1991) the resources of a firm include all assets and capabilities the organizational processes, firm attributes, information and knowledge controlled by a firm that enable the firm to conceive of and implement strategies that improve its efficiency and effectiveness. The systems theory describes resources as those tangible and intangible assets which are tied semi permanently to the firm. For realizing competitive advantages the company has to be capable of mobilizing, coordinating and combining its resources. This theory was found to be relevant to this study because for a SACCO to perform well financially compared to SACCOs which are failing, it must have peculiar capabilities.

2.4 Micro Finance Institutions Models

This study reviewed a number of MFI models that are of direct relevance to the transformation of the MSMEs in Kenya. Five MFI models have been reviewed in

this study, all of them with a discussion on their operational approach. A critique on each of the five models reviewed has also been provided. These five models are divided into two main categories, i.e.; banking oriented models and transaction cost reduction models.

2.4.1 The Banking MFI Models

Three banking oriented models were reviewed, i.e. the Grameen Bank Models, the MC2 bank Model and the Village Banking Model. A discussion on each of these three models is presented below.

a. The Grameen Bank Model

The Grameen Bank (GB) is based on the voluntary formation of small groups of five people, equivalent to ‘Chamas’ in Kenya, to provide mutual, morally binding group guarantees in lieu of the collateral required by conventional banks. Women were initially given equal access to the schemes, and proved to be not only reliable borrowers but also astute entrepreneurs as well. GB has successfully reversed conventional banking practices by removing collateral requirements and has developed a banking system based on mutual trust, accountability, participation and creativity. According to Professor Yunus, the founder of the Grameen Bank in 1976, credit is seen as a cutting edge tool for affecting those inequalities that confine the poor to a poverty cycle and for releasing the inherent capacities in people. Thus, it restores some sort of social power which has been denied to the poor because they lack collateral. Professor Muhammad Yunus argued that the conventional banking system is anti MSMEs, the ‘haves and have nots’, the women and the illiterate. Thus, this approach has contributed to maintaining the status quo between the rich and poor. Thus microcredit issued to small groups, is purported to enable them the opportunity to purchase equipment and other inputs and engage in micro enterprises of their choice.

In terms of methodology, the model is based on the voluntary formation of small groups of five people (equivalent to Kenyan chamas concept) to provide mutual, morally binding group guarantees in lieu of the collateral required by conventional banks. Women were initially given equal access to the schemes and contrary to

what was thought of, they proved to be not only reliable borrowers but also astute entrepreneurs. Intensive discipline, supervision and servicing, characterize the operations of the GB, which are carried out by bicycle bankers in branch units with considerable delegated authority.

Group based lending is one of the most novel approaches of lending small amounts of money to a large number of clients who cannot offer collateral. The size of the group can vary, but most groups have between four to eight members. The group self-selects its members before acquiring a loan. Loans are granted to selected member(s) of the group first and then to the rest of the members. A percentage of the loan is required to be saved in advance, which points out the ability to make regular payments and serve as collateral. Group members are jointly accountable for the repayment of each other's loans and usually meet weekly to collect repayments. To ensure repayment, peer pressure and joint liability works very well. The entire group will be disqualified and will not be eligible for further loans, even if one member of the group becomes a defaulter.

Critique of the Grameen bank model argues that this is one of the most successful models replicated and discussed around the world is the Grameen model. In Kenya, the Rafiki bank has borrowed the same concept and is working closely with 'Chamas' that are the owners of MSMEs. It is no doubt that the Grameen Bank model has successfully served the rural poor in Bangladesh with no physical collateral relying on group responsibility to replace the collateral requirements. However, the model has the following key limitations: a) Setting up a Grameen bank requires putting up a huge mega structure that involves huge costs. Most of the funds obtained from external sources to finance micro and small enterprise projects end up being used to pay operational costs and salaries of personnel working in the mega structure; b) The Grameen Bank Model has degenerated into a level where, MSMEs are being pushed into a cycle of multiple borrowings through the rolling of cash. That is, the poor keep on borrowing to pay previous engagement that is robbing Peter to pay Paul. This in addition to its prohibitive lending rates and high-handed collection mechanisms pushes the poor further below the poverty line. What ought to be a bank-aided socially purposive activity is now a private equity driven business with profits and valuations as the goal with little regards on its impacts on the

members, the MSMEs; c) It involves too much of external subsidy which is not replicable as the bank has not oriented itself towards mobilizing peoples' resources. Thus, in the absence of donors, sustainability of the MSMEs programs become questionable; d) Pressure for high repayment drives members to money lenders. Credit alone cannot alleviate poverty and the Grameen model is based only on credit. Consequently, haste can lead to wrong selection of activities and beneficiaries, thus hindering the intended transformation agenda of the MSMEs; e) It has also been argued that the interest rate charged by the Grameen bank is by far higher than those charged by conventional banks; and f) Finally, agriculture which in most developing countries is the principal activity of the poor is neglected by the model. Direct borrowing of this model by Kenyan MFIs may affect a majority of MSMEs, a majority of which are formed around the issue of agri-business.

The Grameen model calls for the dynamics of joint liability. This mean that groups screen and self select their members to form a relatively homogeneous groups and consequently members typically share similar probability of defaulting on a loan. Again, the poor are again left out due to negative perception of poor people in a community, with no social groups willing to accept the poor.

b. The MC2 Banking Model

MC2 are rural development micro-banks created and managed by a community in keeping to their local values and customs. The principal promoter of this concept, Dr. Paul K. Fokam in 1992, drew inspiration from the Einstein's famous formula: Victory over Poverty (VP) is possible if the Means (M) and the Competences (C) of the Community (C) are combined.

Hence the formula $VP = M \times C \times C = MC^2$. In other words, MC2 is a community based micro banking approach whereby people and mostly the underprivileged endeavour to be self-reliant, create wealth with a view to improving their living conditions in a sustainable manner. The model has two versions: a rural version, MC2 and an urban version dubbed MUFFA. The second version of the model is exclusively for women because studies and personal research of the founder show that women in urban areas are those most hit by poverty. Through MUFFA, these

women have easy access to financial services which help them to start job creation and wealth generating small business activities.

Consequently, the model is built and supported by four main pillars. These are the local populations, the non - governmental organization (NGO), Appropriate Development for Africa (ADAF), Afriland First Bank Group and some national and foreign partners. The objectives of the MC2 Micro bank are simple; a) The first objective of the MC2 micro bank is economic and financial sustainability from the perspective of the micro bank, the individuals and group members; b) The second objective of MC2 is the social dimension. This involves targeting the poor, micro and small enterprise activities and consequently restoring dignity to target beneficiaries to see the importance of being masters of their destiny.

Methodologically, the MC2 Model approach looks at the micro-bank as a more developed and corrects the imperfections of micro-credit and micro finance. It rests on the premise that, savings is the engine of transformational progress of MSMEs and awareness is fuel to keep the engine rolling, while loans serve as a lubricant and finally appended and related service solution to the problem of poverty. MC2 model is not a packaged readymade one size fit all, although the core principles remain the same from one community to the other. Setting up a MC2 micro-bank involves five stages; i) Sensitizing the Poor and Raising their Awareness; ii) Mobilizing Resources; iii) Three-Financing Individual Income Generating Activities; iv) Financing Common Interest Economic Projects; and v) Carrying out Social Development Projects.

At the final stage of MC2, MSME businesses are being financed and carried out with the resources generated in stage three and four. That is, the results are performance registered under stages three and four and that this is, thus critical that the phase to be carried out.

Critiques of the MC2 Model argue that based on the stages of development outlined, it will take about four years for an MC2 to become financially sustainable and another four to five years to accumulate resources. This means, the second objective of the model which is that of social dimension will have to be put aside for at least

ten-15 years. This limits the activities of the model within these periods to the economically viable members; 1) Its low interest rate on savings 2.5% might limit resource mobilization only to true supporters of community development, and those intending to benefit credit in the future. This might cause an upward pressure on loan demand; 2) The model is increasingly appearing to be more of a distribution channel for the link bank. MC2 is a brand of the link bank with most of the services on offer being products and services of the link bank, with very little transformation of MSMEs; and 3) It is clear and eminent in the model the collapse of MC2 or an MSMEs units wouldn't affect the link bank but a problem at the level of the link bank might create panic and result to the suspension of some products such as I-Cards, Flash Cash, and Money First, since these products function on a platform provided by the link bank to the MSMEs.

c. Village Banking Model of FINCA

The village banking institution, Foundation for International Community Assistance (FINCA), first founded in Bolivia by John Hatch in 1984, implements a village banking model in its effort to create financially-sustainable solidarity groups, the MSMEs. FINCA trains small community groups in a 22-module program to form Community Credit Enterprises (CCE). These small enterprises, or companies, permit members to buy shares as shareholders and generate capital to offer sustainable credit and business models.

According to the original model, village banking –FINCA works with groups of 30-60 members, usually all women. As soon as the village bank is inaugurated, it receives its first loan from the implementing agency (the local headquarters of FINCA or its affiliate) for on-lending to the individual members (MSMEs) of the village bank. The sponsoring agency spends one to three months in setting up each bank, organizing the election of a management committee and training its members, as well as developing the rules and regulations to govern the village bank. The first individual loan (usually US\$ 50) is repaid on a weekly basis in equal instalments of principal and interest over a four-month period. The village bank collects these payments at regular meetings and, at the end of the 16th week; it repays the entire loan principal plus interest to the implementing agency. The funds circulating back

and forth between the implementing agency and the village bank for loans to members constitute the external account. If the village bank repays in full, it is eligible for a second loan. If the village bank is unable to pay the amount due, the implementing agency stops further credit until reimbursement is made.

Critiques of the Village banking Model argue that; a) The village banking model of FINCA is over dependent on external funding. This puts the model at risk in a situation where funds are no longer being channelled into the village bank, thus putting at risk the transformation agenda of MSMEs; b) Because funds are being channelled into the village bank at 10% interest rate, the villagers or credit beneficiaries end up paying interest rates of more than 2% on weekly basis. This high interest rate is not sensible considering the meagre resources of the poor and the purpose put forth to defend this initiative; c) The model requires compulsory 20% savings of the loan amount granted with beneficiaries compelled to repay the loan-principal, interest and savings within 16-24 equal weekly installments. This most often is ill adapted to the cycle of activities of the MSMEs, particularly with agricultural financing most of which have but seasonal cash flow; d) Loans are exclusively granted for trading and micro enterprise activities with a maximum amount granted to an individual being limited to \$300 due to the lack of the village bank own resources. The question of how much transformation can, therefore, be achieved with \$300 by MSMEs is a valid one to ask; e) Most village banks are not registered and consequently are not covered by the law and again without an ongoing recruitment and mobilization drive for depositors the village bank can run into problems. Savings are the life-blood of an institution and it enables lending. Therefore concerted attempts to broaden the membership base and ultimately savings volumes are imperative. Most of the village banks have little or no government support.

2.4.2 Transaction Cost Reduction Models

Two Transaction Cost models were reviewed, i.e. the Direct Collection Model (DCM) and the Direct Repayment Model (DRM). A discussion on each of the two models is presented below.

d. Direct Collection Model (DCM)

Ronald Coase, the founder of this model in 1960 argued that after loan disbursement, MFIs collect their loan instalments either on a daily, weekly or monthly basis for a particular tenure. MFIs use the existing manpower for the collection of Equated Instalments (EIs). Under this system the Field Officer (FO) of the MFI goes to field and collects the EIs from the Group/member (MSMEs). The collection point may be the village point or could be an outreach centre. The MFI uses the existing man power for collections, it will not be cost effective and is also unproductive for the MFI's business development. Under this model, the cost involved can be calculated as:

$$T_c = (C_s + C_a + C_o) \times G_v$$

Where,

C = Cost

T_c = Total Transaction cost for Collection per Group

C_s = Average salary of Loan Officer per day

C_a = Average cost of Travel Allowance per day

C_o = Average other charges like phone, refreshments etc. per day

G_v = Average number of groups visited per day by a Loan Officer

The strength of Direct Collection Model is that the Field Officer will have direct contact with the group/members (MSMEs) and there will be regularity in repayment. The loan customer will have Pavlov's syndrome such that she will be tuned that on a particular day and at particular time the Field Officer will come for collection. Hence the customer will make arrangements for repayment of her

equated instalment. If the FO observes any problem with the loan customer the Field Officer can immediately provide credit counselling and achieve on-time repayment. The main problem of this model is the risk factor involved in the transit of cash from field to Bank. Also the financial discipline and commitment of the Field Officer is also a major risk. If the Field Officer involve in malpractices, then the Financial Institution will loose its credibility with their customers.

e. Direct Repayment Model (DRM)

This model, also founded by Ronald Coase, argues that Groups/Members (MSMEs) could come to the branch or MFI collection center for the remittance of their monthly Equated Instalments. This model may not be a fair practice as most of the MFIs are taking the service charge during the disbursement in- order to cover the additional transaction cost. More over members, a majority who may be MSMEs may be located far away from the MFI Branches. Hence the customer has to travel a long distance up and down that involves loss of time and resource for the customer. Further, if a member comes to branch for EI remittance in rural areas, it is likely that a full day is wasted, and she/he will lose their livelihood. The Transaction cost involved could be calculated as:

$$Tc = Ca + Co + Oc$$

Where,

C = Cost

Tc = Total Transaction cost for the Group for repaying the monthly EMI
Ca = Cost of Travel to the MFI branch

Co = Other Charges

Oc = Opportunity cost of the livelihood loss incurred by the leader or member for the day

There is also another threat, the transit risk involved and misappropriation of collected EI by the group leader also. Apart from this, the MFI has to consider the unnecessary cost involved for the groups under this system. Further many MFIs collect service charges/ processing fees, additional expense from the members and hence this practice will not achieve the double bottom line of social and economic transformation of the MSMEs.

2.5 Conceptual Framework

Different scholars define conceptual framework according to the subject under review but all point to the same processes and procedures, followed in solving a problem. Mersland (2009), Smith (2004) defines conceptual framework as a group of concepts that are broadly defined and systematically organized to provide a focus, a rationale, and a tool for the integration and interpretation of information. Reichel and Ramel (1987) define a conceptual framework as hypothesized model identifying the model under study and the relationship between the dependent and independent variables. Kothari (2004) defines an independent variable also known as the explanatory variable as the presumed cause of the changes of the dependent variable, while a dependent variable refers to the variable which the researcher wishes to explain. The goal of a conceptual framework is to categorize and describe concepts relevant to the study and map relationships among them. Such a framework would help researchers define the concept, map the research terrain or conceptual scope, systematize relations among concepts, and identify gaps in literature (Creswell, 2003). Below is a figurative representation of the variables explored by this study.

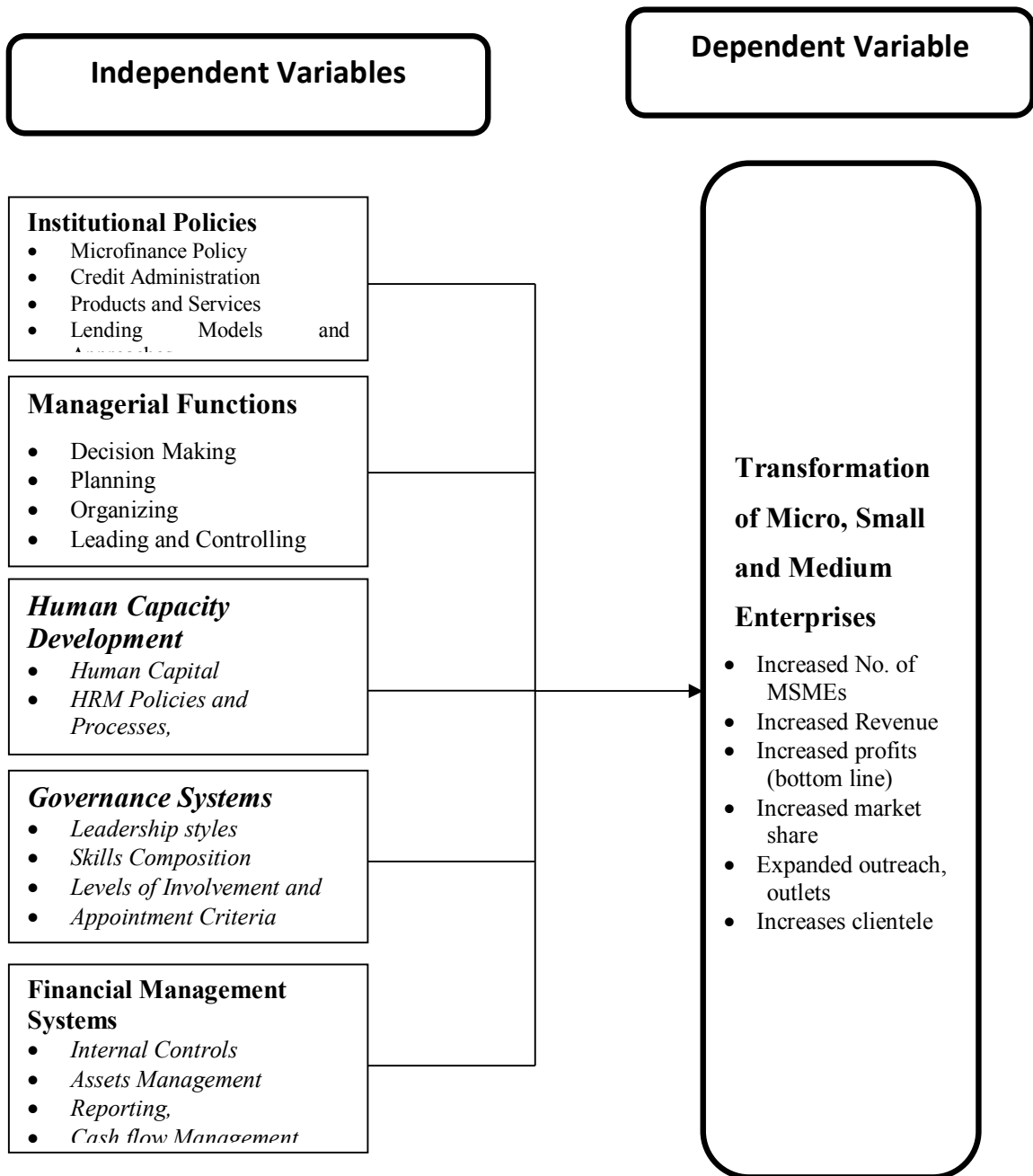


Figure 2.1: Conceptual Framework

2.6 Empirical Literature Review

This section reviews literature from prior scholars regarding the effect of micro finance institutions on the transformation of micro, small and medium enterprises from various contexts.

2.6.1 Institutional Policies and MSMEs

Institutional policy development for MSMEs is intended to focus on improving the business climate for MSMEs generally, with a priority on addressing policies and regulations which create impediments to accessing and providing financing for MSMEs (EBRD, 2006). Policy initiatives should be developed to improve both the regulatory and business environments in the areas of corporate governance and remittances.

According to EBRD (2006) and Dahiru and Zubair (2008) , the focus on policy dialogue is a valuable supplement to the MSME finance work of the Bank, and it is indeed a unique strength of the EBRD compared with other MSME financiers. Proximity to the market in the shape of the relationships with the partner banks and specialized microfinance banks and, through them, to the entrepreneurs they serve, provides a unique perspective on the impediments encountered by both credit providers and borrowers. By bringing these impediments to the attention of the relevant authorities, targeted policy dialogue efforts contribute to an improvement in the environment both for individual MSMEs and the institutions which lend to them (EBRD, 2006).

There have been conflicting ideas about the impact of micro-financing in the transformation of rural dwellers in Nigeria by various researchers. Brau and Woller (2004) noted that the specific impacts of micro-financing are hard to pin down and even harder to measure. They suggested that impact assessment require the adoption of research methodologies capable of isolating specific effect out of a complicated web of casual and mediating factors. Many have subscribed to the believe that micro-financing is an effective and powerful tool for poverty reduction. To affirm the above statement, Morduch (2011) and Roodman and Morduck (2009) focused on the ability of micro finance to reach the poor and concluded that micro-financing has served

people below and above the poverty line. The results of empirical evidence indicates that the poorest can benefit from micro-financing from both on economic and social well being point of views, and that this can be done without jeopardizing the financial sustainability of the micro financial institutions (Dahiru & Zubair, 2008; Nwankwo, 2007).

In a study conducted by Onyeagocha, Chidebelu, Okorji, Ukoha, Osuji and Korie (2012) on the determinants of loan repayment of micro-financing institutions in South East States in Nigeria using a cross-sectional data and a multi-stage sampling technique. The results of the study revealed that the formal segment was more organized, better equipped with higher quality and well motivated staff than the semi-formal and informal segment. Four micro-financing banks were selected as sample size; they are from formal (commercial and development banks), semi-formal (NGO-MFIs and community bank (CB)) and informal (Rotating Savings and Credit Association (ROSCAS)). The study also identify outreach, shocks, training duration, loan size and credit officers experience as the determinants of loan repayment rate in South East States in Nigeria.

Taiwo (2012), in another study of the impact of micro-financing banks on welfare and poverty alleviation in South West States in Nigeria used regression analysis. The study indicated from the analysis of the data collected from the customers of micro-financing banks in Ogun and Lagos States of Nigeria that micro financing has improved the welfare of the enterprises and the individuals in terms of improved savings, earning (both for individual wage earners and the self-employed), facilitated access to loan facilities, improved sales revenue as well as the level of employment and growth in the micro-enterprises examined. The study recommend that since higher education have been found to increase the income of the micro-financing institutions (MFIs) clients; the MFIs clients should be encouraged by the micro-financing institutions (MFIs) to improve on their current level of education by engaging in adult education or life-long learning as this will have the potency to increase their level of income.

Karlan and Zinman (2010) in a field experiment, where, neither group nor individual liability loans are backed by any form of physical collateral, so that the same

borrowers can be subject to one or the other form of liability, used randomized control trial to evaluate the impact of group liability on the performance of clients and the profitability for a lending institution in Philippines. The result showed that, one, individual liability compared to group liability leads to no change in repayment but is better at attracting new clients and keeping existing ones. Two, there is a statistically significant evidence of some of the mechanisms discussed in the group liability literature, such as screening and monitoring, but they did not find that it adds up in an economically meaningful way to higher (or lower) default.

In a comprehensive review of literature carried out by Brau and Woller (2004), a conclusion was made that MFIs provide similar products and services to their customers as formal sector financial institutions. The scale and method of delivery differ, but the fundamental services of savings, loans, and insurance are the same. Notwithstanding, to date most efforts to formalize micro-financing have focused on enterprise lending (loans for enterprise formation and development) which remain by far today the dominant product offered by MFIs (Woller, 2002). This, however, has slowly begun to change. Increasingly today MFIs have begun to offer additional products, such as savings, consumption or emergency loans, insurance, and business education. Hudon and Traca (2011) review the context and rise of micro-financing products and argues there is a need for savings and insurance services for the poor and not just credit products. He goes on to argue that MFIs need to provide tailored lending services for the poor instead of rigid loan products. Supporting the assertion, Khandker (2005) developed a model of small construction management contractors and MFIs in developing countries that provides a tailored lending structure for microenterprise contractors.

Gomez and Eric (2005) provide empirical evidence of the importance of social collateral. In an empirical study of 612 group borrowers and 52 individual borrowers in Canada, they report that group lending and the presence of neighbours have a positive correlation with self-employment earnings. It follows that borrowers with higher earnings will have an easier time of servicing their microloans and performance of MFIs and SACCOs depends on the profile of its members.

The loans demanded by smaller enterprises are smaller than those requested by larger ones but the interest rates remain the same. This indicates that, per unit cost is high for MFIs targeting customers with very small loans and possessing small savings accounts (Robinson, 2006). Even though the interest rate is high for applicants requesting very small loans, they are able to repay and even seek repeatedly for new loans. The social benefits that are gained by clients of MFIs supersede the high interest charged. The high interest rate is also as a means to tackle the problem of adverse selection where a choice is made between risky and non risky projects. The good clients suffer at the expense of the bad ones (Graham, Bannok & Partners, 2007). Micro-financing clients admit that convenience is more important to them than return (Schmidt & Zeitinger, 2004).

Low-income men and women have a serious hindrance in gaining access to finance from formal financial institutions. Ordinary financial intermediation is not more often than not enough to help them participate, and therefore MFIs have to adopt tools to bridge the gaps created by poverty, gender, illiteracy and remoteness. The clients also need to be trained so as to have the skills for specific production and business management as well as better access to markets so as to make profitable use of the financial resource they receive (Banerjee *et al.*, 2009). In providing effective financial services to the poor requires social intermediation. This is “the process of creating social capital as a support to sustainable financial intermediation with poor and disadvantaged groups or individuals” (Banerjee., 2009). Some micro-financing institutions provide services such as skills training, marketing, bookkeeping, and production to develop enterprises. Social services such as health care, education and literacy training are also provided by some MFIs and both enterprise development and social services can improve the ability of the low-income earners to operate enterprises either directly or indirectly (Wydick *et al.*, 2011).

2.6.2 Management Functions and the Transformation of MSMEs

Putting up proper managerial structures and processes in organizations is always a necessity during any development processes (Keraro, 2014; Isoe, 2014). However, this necessity is often handled differently when it comes to the public sector due to various competing demands or factors such politics, financial constraints and

government bureaucracies. According to Dirk and Achterbergh (2011), Fischer (2006) and Mullins (2010) cited in Keraro (2014) held the view that developing management structures that permit institutions to attenuate and amplify talent is a crucial condition for organizational viability. Keraro contends that modern day clamour for lean management structures derive their justification from the fact that they facilitate faster strategic decision making.

Poor communication is a sign of poor leadership and management. Aaltonen and Ikavalko (2005) stated that the amount of strategic communication in most organizations is large with both written and oral communication being used in form of top down communications. However, a great amount of information does not guarantee understanding and there is still much to be done in the field of communicating strategies. Wang (2004) argues that communication should be two way so that it can provide information to improve understanding and responsibility and to motivate staff. Also, they argue that communication should not be seen as a one-off activity throughout the implementation process. In many cases it is not so and therefore communication still remains a challenge to strategy implementation process.

Functions of management include Planning, Organizing, Staffing, Directing and Controlling. Failure of management to carry out these functions leads to lack of clear understanding of strategy. Before any strategy can be implemented, it must be clearly understood. Clear understanding of a strategy gives purpose to the activities of each employee and allows linking whatever task is at hand to the overall organizational direction. Lack of understanding of a strategy is one of the obstacles of strategy implementation (Aaltonen & Ikavalko, 2005). They point out that many organizational members typically recognize strategic issues as important and also understand their context in generic terms. However, the problem in understanding arises when it comes to applying issues in the day to day decision making.

Peters and Pierre (2001) noted that decision making in local authorities settings is a political process. In such a situation, decisions are typically not purely rational but rather incremental, adaptive and predetermined by interactions of political influence and sudden changes in the environment. He further states that strategic planning has

to be accomplished in a pluralistic environment where power is distributed among many and varied interest groups. However, there are very few empirical and theoretical studies on factors affecting implementation of performance contract initiatives. This study aims to contribute to filling this gap using both theoretical and empirical approaches.

A report by the WB (2010, 2012) observed that public servants are working so hard to be sure things are being done right that they hardly have time to decide if they are doing the right things. Though the report highlighted a need to have a hands-on approach to issues by council officers, it did not identify a clear formula on how to ensure councils operations are attained. By addressing factors leading to implementation of effective working formula geared to improving delivery of services, performance contracting is very important and should be researched on all aspects as an on-going process. Studies have revealed that the performance of organizations co-relate directly to the leadership styles of the leaders in the organizations. Traditional views have generally indicated that leaders can impact the performance of the organizations they lead (Thomas, 2008). According to Nave (2006) the success or failure of the business depends on the leadership styles employed by the leaders. Van Wart (2006) states that all organizations need leadership to guide organizational operations. Organizations require efficient leaders who are capable of steering people in the right direction to achieve its mission, vision, and to remain faithful to the philosophy and values of the organization. Plowman, Solansky, Beck and Lekami (2007) reiterate that leaders are the problem solvers who are able to guide the organization through challenges and achieve more through others.

The ability to unite the organization to work towards the organization's goal is the role of an effective leader and it is critical to the organization's success and performance (Stahl, 2007). Great leaders can communicate the organization's future path to a certain group of people effectively and to get them to work as one towards common goals (Buckingham, 2005). Ireland and Hitt (2005) stated that leadership is important to an organization's success and business performance especially in the competitive environment in which firms are presently operating. Lack of managerial skills in most MFIs is attributed to poor management. Most empirical evidence

suggests that firms with better-educated owners and managers are more efficient (Burki & Terrell, 1998) and tend to grow more quickly (Woodruff, Johnson & McMillan, 1999). Capability can be greatly influenced by a person's intelligence, physical ability and level of education. Though there is little one can do about intelligence and physical ability, a compliant level of education can be achieved with time and proper planning by the management by grooming junior and possible chief executives officers to undertake managerial tasks and mandate.

2.6.3 Human Capacity Development and the Transformation of MSMEs

HRM has been linked to the successful growth of many leading organizations. For example, Google has good HRM practices (Lekami, 2007) in place and has made Google one of the greatest companies to work for and managed to retain their best talents Fortune 500 of 2010. Leading organizations such as AT and T, Honeywell, Kodak, and 3M understand the importance of good HRM practice and begin to develop a good and competence HRM practice several years ago. Prudential Insurance also had specialist development tool to assist the evolution of its HR function. It is clear that HRM practice play an essential part in influencing employee's intensity of commitment and their intention to stay with the organization (Roodman & Morduck, 2009).

Human resource is the most important asset for any organization. Grobler, Warmich, Carrell, Elbert and Hatfield (2002) define human resource management as a strategic and coherent management of people working in an enterprise who individually contribute towards the achievement of the enterprises goals. Organizations manage their enterprises through their employees and other resources. Human resource management consists of creating the conditions that allow people to do their best on behalf of the enterprise. Creating right conditions is a matter of motivating people, both individually and on an organizational scale. Creating the right conditions involves specific skills that can be taught (Roodman & Morduck, 2009). A business would become successful if it has a good thread of dedicated employees. CEO wanting to succeed in business should be able to motivate the employees so that the enterprise goals may be achieved. Therefore, determining human resource practices and business policies including MFIs requires special attention.

There is a growing body of work on HRM practice and organizational performance in recent years (Budhwar & Katou, 2010; Lin & Chen, 2007; Sanchez, Jimenez, Carnicer & Perez, 2007) showed an important linkage between HRM practice and organizational performance. HRM practice is identified as resource for organization's continuous growth and sustainable competitive advantage in the business arena (Pfeffer, 1994). The studies recommended that good HRM practice have significant impact on the organization's performance innovation. On top of people management, Huselid, (1995) argued that best HRM practice can be linked to a better financial performance.

Organizational capabilities refer to the skills, experience, and abilities of the individuals within an organization. Capabilities also include decision making practices (Orser *et al.*, 2003), competencies (Julien & Ramangalahy, 2003) and managerial capacity. This theory on organizational capabilities suggests that small firm development depends on the abilities of the firm owner's managers and employees to plan for and adapt to the business environment in which they operate. Successful small firms have been associated with greater skills in organizational learning (Chaston *et al.*, 2001) and strategy development (Julien & Ramangalahy, 2003), Smallbone *et al.*, (1995) document on association of a homogeneous set of organizational competencies with small businesses that have achieved high growth rate. Khandker (2005) and Banerjee and Duflo (2010) identify a positive relationship between a homogeneous collection of organizational capabilities and small business performance, as well as a more heterogeneous set of practices associated with average performance of small firms.

Fasoranti, Akinrinola and Ajibefun (2006) examined the impact of microcredit and training on the efficiency of small scale entrepreneurs in Ondo State. They identified technical efficiency of entrepreneurs to be influenced by human capital variables (which are characterized by level of education, business experience and age) and socio-economic/institutional variables (characterized by loan interest, loan size, contact with lender, training programme and training experience). This they estimated using stochastic production function frontier also called the composed error model of Aigner and ordinary least square. The study is premised on determining the link between access to credit, training and technical efficiency and

highlighting other significant factors that influence the level of efficiency in the baking, furniture making, and burnt brick making micro-enterprises. The result obtained showed initial capital outlay and man hours to be the most significant factors influencing value of output for bakers, while capital outlay, man hours worked and expenditure on equipment in that order to be significant factor influencing value of output for furniture makers. For the burnt brick firms, capital outlay and labour were found to be the most important factors influencing the value of output. The study concluded by showing that the significant determinants of technical efficiencies of bakers, furniture makers and burnt brick makers were of age operators, business experience, and level of education, training experience, credit access, working capital and initial capital outlay. Well-structured entrepreneurship training programmes complemented with easy credit access can facilitate the desired improvement in the efficiency of small scale business people in the State.

Harding, Soderbom and Teal (2004), investigated recent reforms in most African economies of their trading and exchange rate regimes which have eliminated much of the protection which previously limited competition. According to them, despite reforms (in many African countries) aimed at improving the manufacturing sectors, African manufacturing firms remain unsuccessful, particularly in international export markets. They consider the roles of learning, competition and market imperfections in determining three aspects of firm performance, namely firm exit, firm growth and productivity growth. Using pooled panel data set of firms in Ghana, Kenya and Tanzania that spans a period of five years, they found that the main determinant of exit is firm size, with small firms having much higher exit rates than large ones. They also found that productivity affects firm survival among large firms, but not among small firms. They found evidence that, among surviving firms, old firms grow slower than young firms, which is interpreted as evidence consistent with market constraints limiting growth of firms in Africa. There is no evidence that larger firms have faster rates of productivity or input growth, or are more efficient in the sense of benefiting from scale economies. Competitive pressure enhances productivity growth. Given that one of the objectives of the reform programmes implemented in all three countries was to stimulate higher efficiency levels, this finding shows that one aspect of the reform programme has been successful.

Sambhaji (2010) studied the high performance organizational HR practices in selected private sector milk processing organizations in western Maharashtra India. He found that so as for the organization to perform at an excellent level (above 80%) top management had developed scientific HR policies and that the organizations were well versed with the HRD concept. Abang, May-Chiun and Maw King (2009) conducted a study to examine human resource practices and the impact of incentives on manufacturing companies in Malaysia and concluded that training and information technologies have direct impact on organizational performance. Incentive is positively related to organizational performance but did not moderate the relationship between both HR practices and organizational performance.

Kariuki (2006) conducted a study on the effects of human resource management strategies on the effectiveness of coffee marketing organizations in Meru in Kenya and concluded that Human resource strategies affected the performance of the employees directly translating to the performance of the organization as a whole. Organizational development issues like culture management and change affected the general performance of the organization. Knowledge management through sharing vital information and training affected the level of skills and hence the performance of the organization as a whole. However the study did not address the effect of human resource management on organizational performance of commercial banks in Kenya. Nderu (2013) investigated the influence of survival strategies on organizational performance of Kenya Airways and concluded that innovativeness, managerial skills, human resource practices, working capital management practices were statistically significant in explaining organizational performance.

2.6.4 Governance and the Transformation of MSMEs

Corporate governance in most micro-financing institutions is weak and the structure often represents ownership. In NGO governance, the board members do not represent ownership or have profit motivation but a social consideration (Lauer, 2008). Regulation, on the other hand, specifies how institutions' board and management should be structured thereby bringing a challenge. This would imply that a new calibre of board members have to be appointed. Opening up governance of family-owned rural banks, cooperatives and NGOs to bring in board members that have

banking expertise and improve quality in their boards was identified as a challenge in the Philippines (Valentinov, 2007). Another difficult aspect would be the selection criteria to be adopted for the board and senior management for the transformed MFI (Lauer, 2008). The process takes time and is prone to controversy and conflict of interest.

For corporate governance to be effective, it is important to confirm that independent, non-executive directors are not so independent that they do not understand the business. All directors need to understand how value is added in the business, where it is exposed to risk and what are its financial, market and operating strategies. In a nutshell, all directors need to undergo an induction programme regularly so as to keep abreast with changes that occur in business to enable them appreciate their company's place in the competitive market as well as the economic, social and political context in which the company operates (Lauer, 2008).

A board-only organization is one whose board is self-appointed, rather than being accountable to a base of members through elections; or in which the powers of the membership are extremely limited. Inside directors are usually not paid for sitting on a board, but the duty is instead considered part of their larger job description. Outside directors are usually paid for their services. These remunerations vary between corporations, but usually consist of a yearly or monthly salary, additional compensation for each meeting attended, stock options, and various other benefits (Keskin, 2006).

To a great extent, the limited knowledge of board functioning as groups is due to the fact that what takes place within boardrooms is quite difficult for researchers to access (Daily *et al.*, 2003). Corporate directors are hesitant to share information about the inner dynamics of boards for many reasons. Primarily, directors fear that revealing boardroom activities, or even just rating the effectiveness of the board, could have adverse effects on relationships with investors and other board members. Further, there are concerns that exposure to internal practices could increase the risk of shareholder lawsuits should troubles emerge (Langevoort, 2001).

The capacity of the board to function effectively depends on its size and although there is no optimum number of board members, extremes of size should be avoided. BBV Micro-financing Foundation (2011) recommends that a micro-financing board should be big enough to incorporate the various skills and perspectives and boards of 5- 9 directors are common. Boards with less than 5 members pose problems because the necessary skills are not usually found in such a small group, in addition, they will have difficulties finding the quorum required to take decisions. Boards with more than 9 members, unless they are for very large institutions with lots of committees, are usually difficult to manage and do not have the right level of cohesion. However, boards must be small enough to accommodate the need for frequent meetings, ensure a high level of participation and involvement for a streamlined and effective decision –making process given the characteristics of micro-financing (Cherono, 2008; BBV Micro-finance Foundation, 2011; Jacobs, Mbeba & Harrington, 2007).

Mang’unyi (2011) carried out a study to explore the ownership structure and Corporate Governance and its effects on performance of firms. His study focused on selected banks in Kenya. His study revealed that there was significant difference between Corporate Governance and financial performance of banks. The study recommended that corporate entities should promote Corporate Governance to send positive signals to potential investors and those regulatory agencies including the government should promote and socialize Corporate Governance and its relationship to firm performance across industries.

Miring’u and Muoria (2011) analyzed the effects of Corporate Governance on performance of commercial state corporations in Kenya. Using a descriptive study design, the study sampled 30 SCs out of 41 state corporations in Kenya and studied the relationship between financial performance, board composition and size. The study found a positive relationship between Return on Equity (ROE) and board compositions of all State Corporations. Kyereboah-Coleman (2007) carried out a study to examine the impact of capital structure on the performance of micro-financing institutions. Panel data covering the ten-year period 1995-2004 was analyzed within the framework of fixed- and random-effects techniques. His findings were that most of the micro-financing institutions employ high leverage and finance their operations with long-term as against short-term debt. Also, highly leveraged

micro-financing institutions perform better by reaching out to more clientele, enjoy scale economies, and therefore are better able to deal with moral hazard and adverse selection, enhancing their ability to deal with risk.

2.6.5 Financial Management Systems and the Transformation of MSMEs

A study by Cull *et al.*, (2007) provides a new dimension to the existing literature on financial performance of micro-financing institutions. This study attempts to examine financial performance and outreach systematically for the first time in a large comparative study based on a new extensive data set of 124 micro-financing institutions in 49 countries. The authors explored whether there is empirical evidence for a trade-off between the depth of outreach and profitability. They examined this issue by examining 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 financial sustainability (mission drift). They also tested whether a rise in lending rates causes a deterioration of the loan portfolio due to adverse selection and moral hazard.

A study by Kereta (2007) attempted to look at MFIs performance in Ethiopia from outreach and financial sustainability angles using data obtained from primary and secondary sources. The study found that the industry's outreach rose in the period from 2003 to 2007 on average by 22.9 percent. It identified that while MFIs reach the very poor; their reach to the disadvantaged particularly to women is limited (38.4 Percent). From financial sustainability angle, it found that MFIs are operationally sustainable measured by return on asset and return on equity and the industry's profit performance is improving over time. Similarly, using dependency ratio and Non-performing Loan (NPLs) to loan outstanding ratio proxies, the study also finds that MFIs are financially sustainable.

With time microcredit providers have increased their earnings while their costs decreased. In such cases, financial gain has become more important than sustainable development. Cull, Demirguc-Kunt and Murdoch (2007) define mission drift as a shift in the composition of new clients, or a reorientation from poorer to wealthier clients among existing clients. Engels on his publication on The Influence of

Institutional and Country Risk Indicators on the Trade-Off between the Financial and Social Performance of Micro-financing Institutions states ‘On the downsides of micro-financing are the disputable development impact, and the reported cases of high interest rates, and over-indebtedness of its clients. Increasingly more critical attention is given to the profit-making behavior shown by a variety of players in the industry.’ Micro-financing institutions exist in order to generate profits for their shareholders and thus it is important that sufficient profits are generated to allow for dividend payment and if possible for retention to finance future growth. SACCO members also expect a good return in form of dividend. Therefore MFIs and SACCOs are gearing their efforts towards the most profitable areas; seeking the best returns relative to the risk their stakeholders are willing to bear.

Bett (2007) carried out a study that sought to investigate the relationship between the lending interest rate and profitability of Credit Savings and Cooperative Societies in Kenya. The study randomly sampled 20 SACCOs whose net profits and lending interest rates formed a fundamental component of analysis. The study set a singular objective of establishing the relationship between the lending interest rate and profitability of the SACCOs. From data analysis procedures that involved correlation and regression analysis and especially the analysis of the variance (ANOVA), the researcher found that there is a significant relationship between lending interest rates and profitability of SACCOs, the lending interest rate is positively correlated with profitability.

2.6.6 Government Policy and the Transformation of MSMEs

According to Wanjohi (2009 & 2010), Small and Medium Enterprises (SMEs) have been known to contribute greatly to economic growth of both developed and developing countries. According to a report published in the journal of Economic Literature in the year 2000 about the manufacturing firms in developing countries, the share of SMEs in employment tends to be higher in developing countries, which are typically more focused on small-scale production. As such, policy provisions remain fundamental in propelling these enterprises towards self-sustenance and realization of their full potentials in contributing towards economic growth (Wanjohi, 2010; SASRA, 20011).

Wanjohi (2010) further argues that in Kenya, for instance, SME operations cut across almost all sectors of the economy and sustain majority of households. This was well recognized by the 2003, National Budget. David Mwiraria, the then Minister for Finance in Kenya at the time noted that “SME activities form a breeding ground for businesses and Employees, and provide one of the most prolific sources of employment. Their operations are more labour intensive than the larger manufacturers.” As such, policy provisions would mean boosting not only the operations of these enterprises but the country’s economy as well.

In Kenya, SMEs have continued to face challenges related to accessing credit. Commercial banks are still bargaining with the issue of collateral. Due to limited land ownership status in Kenya (Property Rights in Kenya), entrepreneurs are unable to provide the necessary collateral needed for loan requests. According to the International Labour Organization report of 2008, Factors affecting Women Entrepreneurs in Small Enterprises in Kenya, women make up nearly half of all Small and Medium Enterprises owners and 40 percent of smallholder farm managers, yet they have less than 10 percent of the available credit and less than 1 percent of agricultural credit. Despite the fact that some provisions have been made towards gender mainstreaming, there is much more that could be put in place.

The journey towards MSME policy formulation by the Kenyan government has been long (Wanjohi & Mugure, 2008). The government’s commitment to foster the growth of Small and Medium Enterprises (MSEs) emerged as one of the key strategies in the 1986 report: Economic Management for Renewed Growth. It was reinforced as a priority in the 1989 report, The Strategy for Small Enterprise Development in Kenya: Towards the Year 2000. This report set out the mechanisms for removing constraints to growth of the MSE sector. In 1992, the government published the MSE policy report, Sessional Paper No. 2 Small Enterprises and Jua Kali Development in Kenya (Wanjohi, 2010). The report was reviewed in 2002, leading to a new policy framework that provides a balanced focus to SME development in line with the national goals of fostering growth, employment creation, income generation, poverty reduction and industrialization.

However, though these efforts are commendable, these are but perhaps baby steps compared to the task that lies ahead, namely unlocking the full potential of the MSMEs sector to spur and sustain economic growth. For there to be long lasting changes, it is imperative for there to be concerted efforts starting at the policy level especially when it comes to issue identification and solution architecture. This is because, like in many developing countries, there have been considerable mountains of policy publications, data and research yet the problems still remain.

Kenya has had a long history of economic leadership in East Africa as one of its largest and most advanced economies. However, inconsistent efforts during the structural reforms era coupled with poor economic policies and state complicit corruption syndicates over the past decades have haemorrhaged development and growth significantly eroding the leadership at a time when other countries in the region have made significant strides (Wanjohi & Mugure, 2008). The dichotomous policy perception of formal and informal business entities has also contributed to ineffective policies on the SME economy as merely-jua kali (CGAP, 2008). It was not until the beginning of 2003 that there was deliberate Government debate on the need to integrate the two sectors. At the time, analysis of the SME sector revealed that development and integration of both the informal and formal sectors has to a large extent been constrained by regulatory requirements. Most of these requirements date back to the colonial period and have no relevance in independent Kenya.

There is no doubt that small and medium-sized firms are the drivers of the Kenyan economy (Wanjohi, 2010; Cheron, 2008). They employ about 7.5 million Kenyans or 80 per cent of the country's total employment outside the small-scale agriculture. But little has been understood about their operations, ownership, source of capital and the key challenges that they face as they propel growth of the Kenyan economy. This could be the reason why they should be supported to graduate from their current state. Perhaps we should ask: are there certain efforts in progress? For one, lack of insight on the sector has left policy makers, key support players such as financial institutions and others groping in the dark on how best to implement MSME policies.

2.7 Research Gaps

A critical review of past literature show that several conceptual and contextual research gaps existed in demonstrating whether micro finance institutions influence the transformation of micro, small and medium enterprises into viable businesses in Kenya. For instance, much of the literature in this area addresses the social worth of micro-financing organizations (Bruett, 2005), measuring for example; the impact of village level MFIs (Menkhoff & Rungruxsirivorn 2011; Kaboski & Townsend, 2005), the impact of microcredit on the poor (Karlan & Zinman 2010; Kaboski & Townsend 2011), costs and benefits of subsidies micro-financing and mission drift. Other studies include efficiency of MFIs (Gutiérrez-Nieto *et al.*, 2010; Caudill, Gropper and Hartarska, 2009), micro-financing commercialization (Banerjee *et al.*, 2009; Hermes & Lensink, 2011; Hudon & Traca, 2011), outreach sustainability trade off (Hermes & Lensink 2011; Cull, Demirgüc-Kunt & Morduch 2007) and performance and corporate governance (Mersland, 2009).

According to Cull *et al.* (2007) there is evidence that raising interest rates resulted in increased profitability for individual based lending MFIs whereas for solidarity based lenders, the reverse is true. This paper also found evidence that raising the interest rates lead to improved financial performance and profitability with lower subsidy dependence and higher operational self-sufficiency. Pankaj and Sinha (2010) came to the conclusion that most of the best performing firms are following different business models in India. This is reflected in 13 out of 22 parameters studied. However, in other areas especially in risk coverage, debt equity ratio, productivity, cost per borrower and operational self-sufficiency among others, exists similarity between the firms performance. Ahlin *et al.* (2011) examined the determinants of performance of MFIs with variables, such as self-sufficiency, borrower growth or loan-size growths are estimated by macroeconomic variables as well as macro-institutional factors, such as corruption control. One of their main conclusions included that MFIs performance is not necessarily good or sometimes worse in the country where institutions are more advanced.

Locally, Njagi (2011) made an investigation of factors affecting performance of micro-finance institutions: a case study of Central Division of Embu district and

concluded that the key reasons behind low performance of the institutions included limited financial resources, loan defaults by recipients, poor management information systems and poor research and development departments among others. Mahinda *et al.* (2005) carried out a study to evaluate the use of financial performance indicators by micro-financing institutions in Nairobi. The study also looked at the relationship between the sources of finance and the financial performance indicators used by these MFIs. Mirichii (2003) looked at financial performance of urban savings and credit co-operatives (SACCOS) in Nairobi. There have been a number of studies on the performance of MFIs. There has however, been limited up-to-date scholarly work detailing the influence of microfinance institutions in transforming micro, small and medium enterprises into viable businesses in Kenya.

2.8 Chapter Summary

This chapter has reviewed the various theories that explain the independent and dependent variables. The reviewed theories are then critiqued for relevance to specific variables. The chapter also explored the conceptualization of the independent and the dependent variables by analyzing the relationships between the two set of variables. In addition, an empirical review was conducted where past studies both global and local were reviewed in line with the following criteria, title, scope, methodology resulting into a critique. It is from these critiques that the research gap was identified.

The aim of micro-financing according to Otero (1999) is not just about providing capital to the poor to combat poverty on an individual level, it also has a role at an institutional level. It seeks to create institutions that deliver financial services to the poor, who are continuously ignored by the formal banking sector. Littlefield and Rosenberg (2004) state that the poor are generally excluded from the financial services sector of the economy, so MFIs have emerged to address this market failure. By addressing this gap in the market in a financially sustainable manner, an MFI can become part of the formal financial system of a country and so can access capital markets to fund their lending portfolios, allowing them to dramatically increase the number of poor people they can reach (Otero, 1999).

Hartarska and Nadolnyak (2008) used the financing constraints approach to study the impact of micro-financing on access to credit for microenterprises in Bosnia and Herzegovina. Using sensitivity analysis and multiple regression analysis, the data and method employed produced results consistent with more traditional impact studies in Bosnia for the same period. The results indicated that MFIs improved access to credit in municipalities where two or more MFIs offered financial products because investment in local microenterprises was less sensitive to availability of internal funds than was investment in microenterprises in municipalities where micro-financing activities were limited or non-existent and where micro entrepreneurs had to rely more on internal funds for investment. The methodology is appropriate for other countries where Living Standard Measurement Surveys or similar large scale household surveys are conducted and where data on geographic distribution of MFIs branches can be assembled. The popularity of micro-financing forces MFIs to be more transparent and decreases the cost of assembling a database with MFIs branch distribution, therefore making the financing constraints approach more attractive for use in the future.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter presents the methodology and research design adopted in conducting this study and collecting the desired data. The chapter defines the target population of the study, the sampling size used, sampling procedure followed and as well as the type of instrument used. The data collection procedures and data analysis techniques used in analysing the results of the study are also discussed. This research study was both descriptive and quantitative in nature. Therefore, descriptive and quantitative methods of research were used in analyzing data collected to achieve the research objectives.

3.2 Research Design

This study relied on a Positivist Research Philosophy. In Keraro (2014), Cohen and Crabtree (2006), Bryman (2001) and Levin (1997) are quoted to argue that a positivist approach to research is based on knowledge gained from “positive” verification of observable experience rather than introspection or intuition. May (1997) stated that the positivist philosophy presupposes that there is an objective reality that people can know reality and that symbols can accurately describe and explain this objective reality. The positivist approach holds three main beliefs (Cohen & Crabtree, 2006; Creswell, 2003): namely: (i) Prediction and control; that there are general patterns of cause and effect that can be used as a basis for predicting and controlling natural phenomena and the goal is to discover this phenomena; (ii) Empirical verification, that a researcher could rely on perceptions (observations or measurements) of the world to provide accurate data and; (iii) Research is value free; that provided a strict methodological protocol is followed, research will be free of subjective bias and objectivity will be achieved. Another study by Schiffman and Kanuk (1997), also cited in Keraro (2014) observed that principal positivist methods often involve statistical analysis in order to generate findings and to test hypotheses.

A research design is the structure of research. Orodho (2003) defines it as the scheme outline or plan that is used to generate answers to research problems. Newing (2011) states that the term ‘research design’ is used both for the overall process described above (research methodology) and also, more specifically, for the research design structure. The latter is to do with how the data collection is structured. According to Lavrakas (2008), a research design is a general plan or strategy for conducting a research study to examine specific testable research questions of interest.

Yang (2008) states that the phrase “research design” denotes both a process and a product aimed at facilitating the construction of sound arguments. Research design is the plan, structure of investigation conceived so as to obtain answers to research questions and to control variance (Kerlinger, 1986). The nature of the study –whether it is exploratory, descriptive or experimental depends on the stage to which knowledge about the research topic has advanced (Sekaran, 2006). Available research strategies include experiment, survey, case study, action research, grounded theory, ethnography and archival research. The choice of the research strategy is guided by the research question(s) and objective(s), the extent of existing knowledge, the amount of time and resources available as well as the philosophical underpinning (Saunders, Lewis & Thornhill, 2007). Schwab (2005), states that a research design establishes procedures to obtain cases for study and to determine how scores will be obtained from those cases.

A cross-sectional research design, in the form of a survey was used in this study. According to Sekaran and Bougie (2011), a cross-sectional research design used when the purpose of the study is descriptive, often in the form of a survey; which is true for this study. Usually the aim of the cross-sectional study (John & Johnson, 2002) is to describe a population or a subgroup within the population with respect to an outcome and a set of risk factors. The purpose of the study was to find the prevalence of the outcome of interest, for the population or subgroups within the population at a given time point. Cross-sectional studies are sometimes carried out to investigate associations between risk factors and the outcome of interest. They are limited, however, by the fact that they are carried out at one time point and give no indication of the sequence of events — whether exposure occurred before, after or during the onset of the disease outcome.

3.3 Population

Burns and Grove (2003) states that population includes all elements that meet certain criteria for inclusion in a study. Target population consists of all members of a real or hypothetical set of people events or objects from which a researcher wishes to generalize the results of their research while accessible population consists of all the individuals who realistically could be included in the sample (Borg & Gall, 2007). Newing (2011) describes a population as the set of sampling units or cases that the researcher is interested in. According to Kothari (2004), a population refers to all items in any field of inquiry and is also known as the 'universe'.

The population of this study comprised of 45 units of analysis which are the micro finance institutions registered by the Association of Micro-financing Institutions of Kenya (AMFI) in Kenya. The target population and accessible population were drawn from the 45 MFIs who are members of AMFI. Target and accessible population comprised of top management, middle management and supervisory level employees from the micro financing institutions.

3.4 Sampling Frame

A sampling frame is a list of population from which a sample was drawn (Leary, 2001). It is the source material or device from which list of all elements within a population that can be sampled is drawn (Sarndal, Swensson & Wretman, 1992) and may include individuals, households or institutions. It's a published list in which or a set of directions for identifying a population (Gall, Gall & Borg, 2007). Jessen (1978) highlights its importance based on features such as single representation of each and every element, numerical identifiers, contact information, maps, location and other relevant information presented in a logical and systematic fashion and exclusion of elements outside the population of interest (Sapsford & Jupp, 2006). Examples in real life would be electoral registers, attendance registers and so on.

A sampling frame facilitates formation of a sampling unit that refers to one member of a set of entities being studied which is the material source of the random variable (Bailey, 2008; Cochran, 1977; Sarndal, Swensson & Wretman, 1992). Common examples of a unit would be a single person, animal, plant, or manufactured item that

belongs to a larger collection of such entities being studied. For the purpose of this study, a sampling frame of 45 MFIs registered at AMFI was used. The sampling frame for the target population is the employee data bases of all the 45 registered MFIs in Kenya. The employee data base was derived from human resource records of the MFIs in liaison with the human resource departments.

3.5 Sampling Design

A sample design is the architecture or the strategy used to select study participants or respondents (Kothari, 2004). Sampling refers to the systematic selection of a limited number of elements out of a theoretically specified population of elements. The rationale is to draw conclusions about the entire population. According to Kothari (2004), the ultimate test of a sample design is how well it represents the characteristics of the population it purports to. The reason for sampling in this study is to lower cost, accessibility of study population and the greater speed of data collection. This study used stratified random sampling method on all the micro finance institutions. Stratified random sampling was used in each MFI to group respondents into three strata; namely, top management, middle management and supervisors. Within each of the three strata simple random sampling was done to identify individual respondents who were issued with a questionnaire to respond to research questions.

Stratified random sampling was used in this study as it ensured a greater statistical efficiency, and reduced sampling error. Kothari (2004) supports random sampling as it satisfies the law of statistical regularity ‘if a sample is chosen at random, on average it has the same characteristics and composition as the population’.

3.6 Sample Size

Kombo and Tromp (2009) and Kothari (2004) describe a sample as a collection of units chosen from the universe to represent it. Yang (2008) defined a sample as subset of the population to be studied. Sampling is the selection of a subset of individuals from within a population to yield some knowledge about the whole population, especially for the purposes of making predictions based on statistical inference (Scott & Wild, 1986). Its main advantages are cost, speed, accuracy and

quality of the data (Ader, Mellenbergh & Hand, 2008). The sampling process comprises of defining the population, sampling frame, sampling method, sample size and sample plan (Lavrakas, 2008). This study, therefore, sampled only employees in the cadres of senior management, middle management and supervisory staff. The target sample of 135 management employees is shown on Table 3.1.

Table 3.1: Sample Matrix

Category	Sample Per MFI	Total Sample Size
Top Management	1	45
Middle management	1	45
Supervisory Management	1	45
Total	3	135

3.7 Data Collection Instruments

This study relied on primary data. Questionnaires were the main tools for collecting the primary data. Data has been analyzed quantitatively and qualitatively and presented descriptively and illustrated by use of tables and charts as shown in chapter 4. Kothari (2004) defines a questionnaire as a document that consists of a number of questions printed or typed in a definite order on a form or set of forms. According to Dawson (2002), there are three basic types of questionnaires; closed ended, open-ended or a combination of both. Closed-ended questionnaires are used to generate statistics in quantitative research while open-ended questionnaires are used in qualitative research, although some researchers will quantify the answers during the analysis stage. Obtaining data from participants with different methods and experience helped prevent information bias and thus increased credibility regarding the information collection (Louis, Lawrence & Morrison, 2007).

Mugenda and Mugenda (2003) and Kothari (2004) agree that questionnaires have various merits like; there is low cost even when the universe is large and is widely spread geographically; it is free from the bias of the interviewer; answers are in respondents' own words; respondents have adequate time to give well thought out answers; respondents who are not easily approachable can also be reached

conveniently; large samples can be made use of and thus the results can be made more dependable and reliable.

According to Kothari (2004), the main demerits of questionnaires are; low rate of return of the duly filled in questionnaires; bias due to no-response is often indeterminate; it can be used only when respondents are educated and cooperating; the control over questionnaire may be lost once it is sent; there is inbuilt inflexibility because of the difficulty of amending the approach once questionnaires have been dispatched; there is also the possibility of ambiguous replies or omission of replies altogether to certain questions i.e. interpretation of omissions is difficult; it is difficult to know whether willing respondents are truly representative and this method is likely to be very slow. In view of the advantages and the need to gather more information a combination of open and closed ended questionnaires were administered to top management, middle management employees and supervisors in all the 45 micro finance institutions registered with AMFI. Interview guides were also used to make specific follow ups and clarify on responses from those to be interviewed.

3.8 Data Collection Procedure

Burns and Grove (2003) define data collection as the precise, systematic gathering of information relevant to the research sub-problems, using methods such as interviews, participant observations, focus group discussions, narratives and case histories. This study used questionnaires to obtain both quantitative and qualitative data for analysis. Yang (2008) states that the questions in a study are directly related to the research questions. In development of a survey questionnaire, the variables for which information needs to be collected have to be identified followed by their operational definition. According to Newing (2011), questionnaires consist of a series of specific, usually short questions that are either asked verbally by an interviewer, or answered by the respondent on their own (self-administered). Primary data was collected through the administration of questionnaires to employees and management of MFIs. Kothari (2004) describes primary data as those which are collected afresh and for the first time, and thus happen to be original in character. Louis et al., (2007) describes primary data as those items that are original to the problem under study.

Polit and Beck (2003) describes a primary data source as the original description of a study prepared by the researcher who conducted it.

3.9 Pilot Test

To check for the validity and reliability of the questionnaires in gathering the data required for purposes of the study, a pilot study was carried out. The purpose of pilot testing was to establish the accuracy and appropriateness of the research design and instrumentation (Saunders, Lewis & Thornhill, 2007). According to Newing (2011), the importance of field piloting cannot be overemphasized; you will almost always find that there are questions that people fail to understand or interpret in different ways, places in the questionnaire where they are not sure where to go next, and questions that turn out simply not to elicit useful information. Cooper and Schindler (2006) concur that the purpose of pilot test is to detect weaknesses in design and implementation and to provide proxy for data collection of a probability sample. Sekaran (2008) reinforces that pilot test is necessary for testing the reliability of instruments and the validity of a study. The results of the pilot test of this are reported in Table 4.1 of Chapter 4 and Annex VI.

3.10 Instrument Reliability and Validity

Reliability refers to the repeatability, stability or internal consistency of a questionnaire (Jack & Clarke, 1998). Cronbach's alpha was used to test the reliability of the measures in the questionnaire. According to Sekaran (2008), Cooper and Schindler (2003), Cronbach's alpha has the most utility for multi-item scales at the interval level of measurement, requires only a single administration and provides a unique, quantitative estimate of the internal consistency of a scale.

Baker (1989) states that the size of a sample to be used for piloting testing varies depending on time, costs and practicality, but the same would tend to be 5- 10 per cent of the main survey. According to Cooper and Schindler (2006) the respondents in a pilot test do not have to be statistically selected when testing the validity and reliability of the instruments. In this study, data collection instrument, which is a questionnaire, was tested on 10% of the sample of the questionnaires to ensure that was relevant and effective. Reliability was tested using questionnaires duly

completed by fourteen (14) randomly selected respondents. The results of the pilot test of this are reported in Table 4.1 of Chapter 4 and Annex VI.

3.11 Data Processing and Analysis

According to Zikmund *et al.*, (2010), data analysis refers to the application of reasoning to understand the data that has been gathered with the aim of determining consistent patterns and summarizing the relevant details revealed in the investigation. To determine the patterns revealed in the data collected regarding the selected variables, data analysis was guided by the aims and objectives of the research and the measurement of the data collected. Information was sorted, coded and input into the statistical package for social sciences (SPSS) for production of graphs, tables, descriptive statistics and inferential statistics. Multiple linear regression models have been used to test the significance of the influence of the independent variables on the dependent variable. The multiple regression and descriptive results from this study are reported in section 4.3 of Chapter 4.

The variables of this study, X_i (independent variables) and Y_i (dependent variable) suggest a linear relationship which may generally take the form, $Y_i = f(X_i)$. This means that the outcome of the relationship Y_i is a function of X_i (i.e. y regressed on x). The linear regression model, thus, used was one that represented the expectation of a random variable, Y , given a linear combination of functions of the explanatory variables; $X_1, X_2, X_3, \dots, X_n$.

To carry out investigations on each of the specific objectives of the study, the study proceeded as follows;

Determining whether MFI institutional policies played a role in transforming Micro, Small and Medium Enterprises in Kenya

For this objective, use of linear regression, principal component and factor analyses was found useful in this study. Linear regression attempts to model the relationship between two variables by fitting a linear equation to observed data. One variable is considered to be an independent (explanatory) variable, while the other is considered

to be a dependent variable as discussed in the paragraph above. In this case, the researcher will seek to derive a function of the form:

$$Y = a + bX + e \dots\dots\dots \textit{Equation 1}$$

where X was Institutional Policies and Y was the transformation of MSMEs. The slope of the line is b , and a is the intercept (the value of y when $x = 0$), e is error term.

Investigating the influence of MFI management functions in transforming Micro, Small and Medium Enterprises in Kenya

This second objective was addressed using linear regression, principal component analysis and factor analysis. The detailed results are resented in Chapter 4 and summarized in Chapter 5. Here the independent variable (X) was management functions while the dependent variable (Y) was the transformation of MSMEs.

Establishing whether MFI human resource capacity Development contributes to transforming Micro, Small and Medium Enterprises in Kenya

Correlation analysis, principal component analysis and factor analyses were used to investigate whether of human resource management contributed to transforming micro, small and medium enterprises in Kenya. Correlation analysis is statistical analysis that defines the variation in one variable by the variation in another, without establishing a cause-and-effect relationship. The coefficient of correlation is a measure of the strength of the relationship between the variables; that is, how well changes in one variable can be predicted by changes in another variable. Correlation coefficient (typically denoted by the statistic “ r ”) describes the strength of the relationship between two variables. Correlations range from -1.0 to +1.0 in value.

Examining whether governance systems of MFIs has influence in transforming Micro, Small and Medium Enterprises in Kenya

For this objective, the study performed principle component analysis (PCA) and then factor analysis so as to know the mainstream variables. Thereafter, a multiple

regression model was used and the results are discussed in chapter 4. The multiple linear regression model allows for more than one independent variable.

$$Y_i = b_0 + b_1X_1 + b_2X_2 + e \dots\dots\dots \textit{Equation 2}$$

Where, Y is the dependent variable, in this case growth of MSMEs and X₁ , X₂...X_n are the various independent variables determining the transformation of MSMEs

Ascertaining the influence of MFI’s financial management systems in transforming Micro, Small and Medium Enterprises in Kenya

Here, analysis of variance (ANOVA), principle component analysis (PCA) and factor analysis so was conducted. In the simplest form, ANOVA provides a statistical test of whether or not the means of several groups are all equal, and therefore generalizes *t*-test to more than two groups. ANOVAs are useful in comparing two, three, or more means.

Multiple regression and multiple correlation (R^2) were performed after subjecting the various variables to the above tests and the actual results achieved are reported in chapter 4.

CHAPTER FOUR

RESEARCH FINDINGS AND DISCUSSION

4.1 Introduction

The main objective of the study was to determine the influence of Microfinance Institutions in transforming Micro, Small and Medium Enterprises in Kenya. This chapter presents findings on the following five MFI research areas: institutional policies; management functions; human resource management; governance; and financial management systems. Results on the moderating effect of government policies between the five research areas and the transformation of Micro, Small and Medium Enterprises in Kenya are also discussed in this chapter. The research findings on each question used in the study are corroborated with the empirical and theoretical literature reviewed in chapter two. At the end of each study question, the findings are briefly discussed and inferences drawn. Summary descriptive statistics, Regression and Correlation Analyses and Analysis of Variance (ANOVA) are presented for each study variable together with the fitting of a model.

4.2 Preliminary Results

This section presents findings of key preliminary results of the research.

4.2.1 Response Rate

The researcher distributed 135 questionnaires from which 102 were duly filled and returned, making a response rate of 76%. Nachmias and Nachmias (2004) posited that survey researches face a challenge of low response rate that rarely goes above 50%. They further suggest that a response rate of 50% and above is satisfactory and represents a good basis for data analysis. According to Mugenda and Mugenda (2003) a 50% response rate is adequate, 60% is good and above 70% is very good. This also concurs with Kothari (2004) assertion that a response rate of 50% is adequate, while a response rate greater than 70% is very good. This implies that based on this assertions; the response rate based on the correctly returned

questionnaires and used for analysis of 76% was adequate for proceeding with the study. Table 4.1 presents the response rate results.

Table 4.1: Response Rate

Details	Response
Questionnaires distributed	135
Questionnaires correctly filled and returned for analysis	102
Response Rate	76%

4.2.2 Pilot Test Results on Instrumentation

Cronbach’s alpha coefficients were used to check on the reliability among multiple measures and the internal consistency of the variables of the study. As argued in Keraro (2014), Cronbach’s alpha is a reliability coefficient that indicates how well the items in a set are positively correlated to one another. It is computed in terms of inter-correlation among the items measuring the concept. The closer Cronbach’s alpha is to 1, the higher the internal consistency (Sekaran, 2010; Keraro, 2014) If the Cronbach’s alpha is above 0.7 the instrument is reliable. While it is generally agreed that loadings from factor analysis of 0.7 and above are preferable for analysis, Rahim and Magner (2005) explained that researchers use 0.4 as a realistic measure given that 0.7 can be high for real life data to meet this threshold.

Tavakol and Dennick (2011), cited in Keraro (2014) argued that a high alpha coefficient does not always mean a high degree of internal consistency. This is because alpha is also affected by the length of the study i.e. the number of items or questions contained in the study. The scholars stated that “to increase alpha value, more related items testing the same concept should be added to the study”. Sekaran (2010) explained that reliability of a measure indicates the extent to which it is without bias and hence ensures consistent measurement across time and across the various items in the instrument. As indicated in Annex VI, all the components show a value of above 0.4 or very close to 0.4 and above. Those that did not meet this criterion were dropped as they were not considered significant for analysis.

Cronbach's alpha coefficient results on the independent variables are presented in Table 4.2.

Table 4.2: Reliability Test Results

Variable Description	Nature of Variable	Cronbach's Alpha	No. of Items
Institutional Policies	Independent	.729	5
Management Functions	Independent	.865	6
Human Capacity Development	Independent	.797	5
Governance System	Independent	.767	6
Financial Management Systems	Independent	.661	4
Transformation of MSMEs	Dependent	.476	4

4.2.3 Gender of the Respondent

The study sought to find out the gender distribution of the respondents. The results shown in Figure 4.1 indicate that, a majority (57.4%) were male while 42.6% were female respondents. This was a fair distribution which depicts a fair balance of gender, accommodating the opinions and views from both sides of the gender divide.

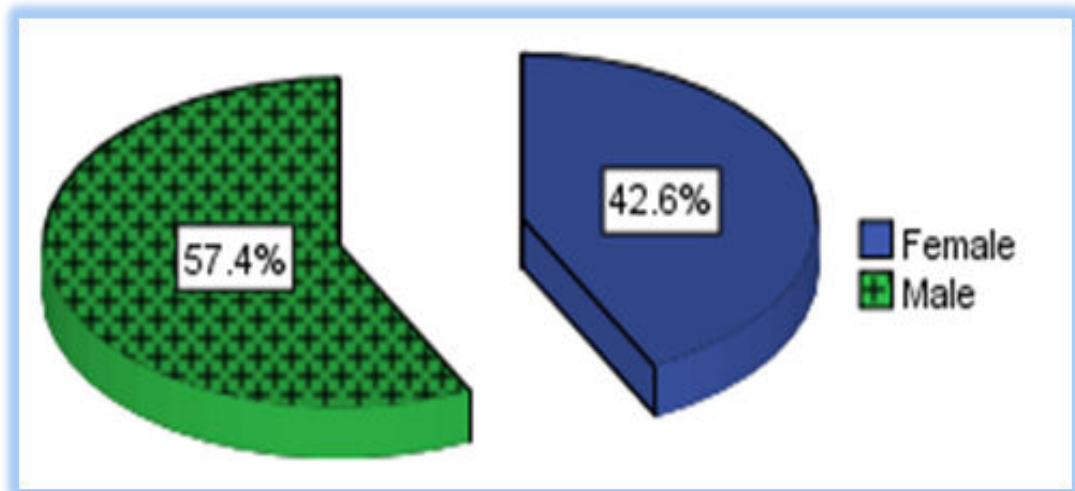


Figure 4.1: Gender of the Respondents

4.2.4 Department of the Respondents

The study sought to find out the departments in the organization where the respondents worked. The findings are summarized in Table 4.3. These results indicate that 19.4% of the respondents came from the administration department, 19.4% were from the accounts and finance department, 21.3% were from the risk and compliance department, 11.1% were from the human resource department while a majority of 28.7% was from operations technology department.

Table 4.3: Departments of the Respondents

	Frequency	Percent	Cumulative Percent
Administration	21	19.4	19.4
Accounts and Finance	21	19.4	38.9
Risk and Compliance	23	21.3	60.2
Human Resources	12	11.1	71.3
Operations and IT	31	28.7	100.0
Total	108	100.0	

4.2.5 Position of the Respondent in the Organization

The researcher asked the respondents the position they occupied in the companies they worked for. From the findings presented in Figure 4.2, a majority (39.6%) of the respondents said they held middle level management positions, 35.5% held top management positions, while 24.5% were in supervisory positions.

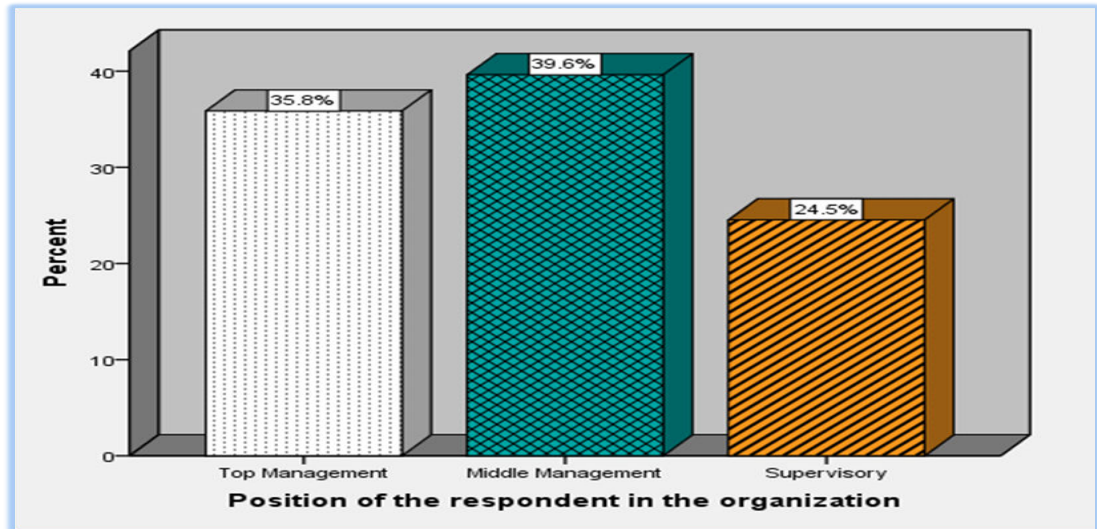


Figure 4.2: Position in the company

4.2.6 Educational Qualifications of the Respondents

The researcher sought to find out levels of educational qualifications of the respondents. The findings are presented in Figure 4.3. From the figure below, 9.6% of the respondents were Graduates from Tertiary colleges, 57.7% of the respondents had under graduate qualifications, while 32.7% of the respondents were post graduates. These findings indicated that all the respondents had adequate educational qualifications thus furnished this study with good information which was value adding to the study.

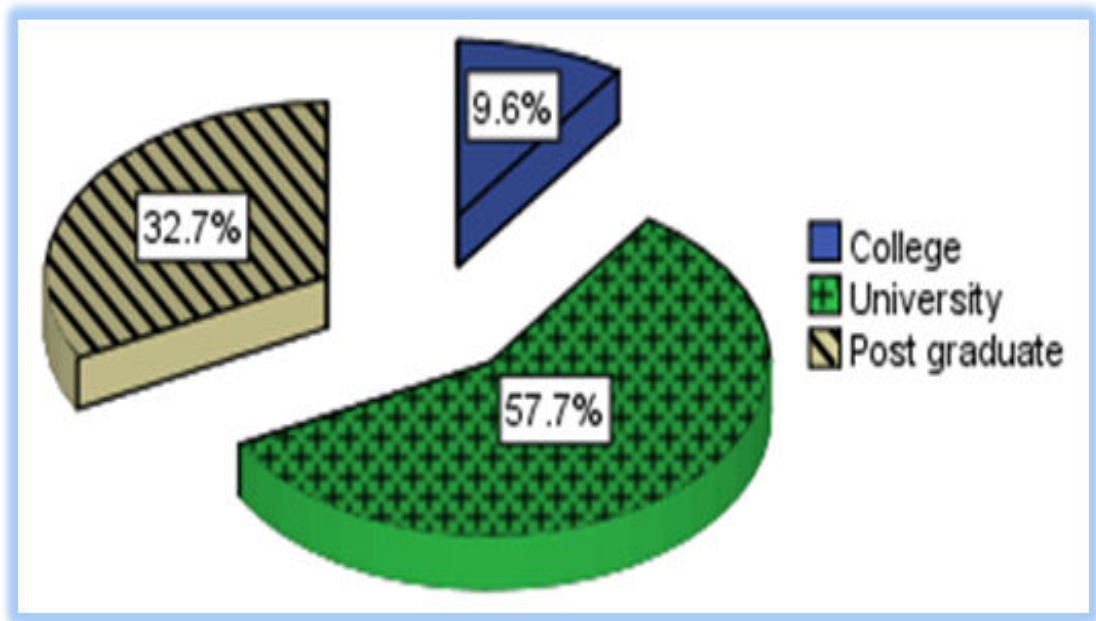


Figure 4.3: Education Qualifications of the Respondents

4.2.7 Duration the Respondents have been employed by the Company

The research sought to establish the duration the respondents had served in their respective organizations. The findings presented in Figure 4.4 below show that a majority (63.2%) had worked for between 2 and 5 years, 24.5% had worked for 6-10 years, 7.5% had worked for less than 1 year, and 4.7% had worked for over 10 years with the respective companies. These findings indicated that 92.4 % of the respondents had worked for their respective MFIs for a period of between 2- 10 years an indication that they had adequate knowledge of their institutions and thus furnished this study with good information which was value adding to the study.

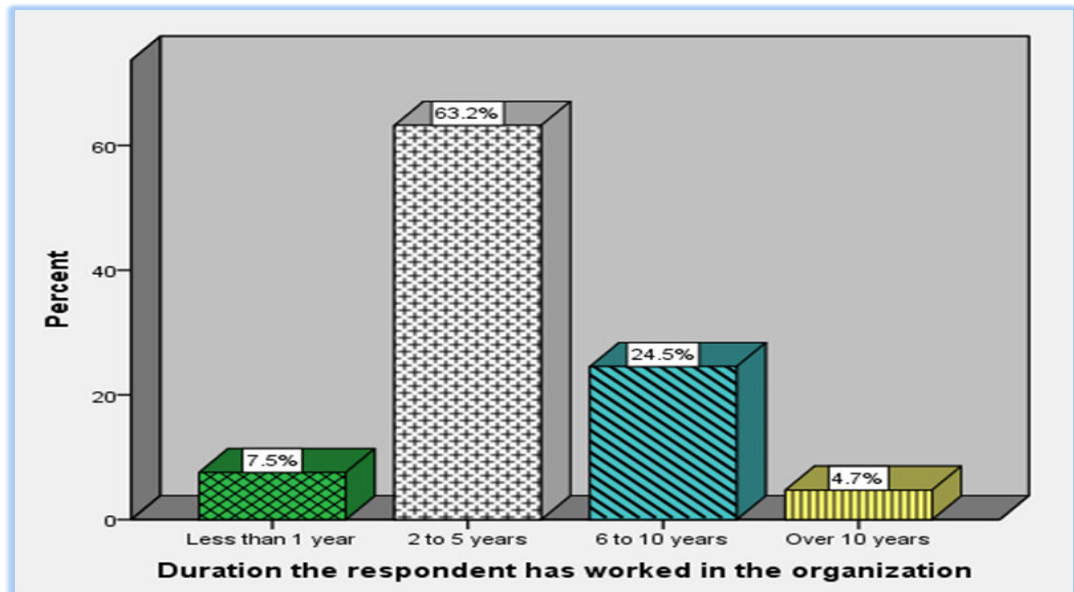


Figure 4.4: Duration the Respondents have been employed by the Company

4.2.8 Testing for Multicollinearity

According to Besley, Kuh and Roy (1980) cited in Keraro (2014), identification of multicollinearity in a model is important and is tested by examining the tolerance and the variance inflation factor (VIF) diagnostic factors. The variance inflation factor (VIF) measures the impact of multicollinearity among the variables in a regression model. Green (2000), also cited in Keraro (2014) concluded that even though there is no formal criterion for determining the bottom line of the tolerance value or VIF, tolerance values that are less than 0.1 and VIF greater than 10 roughly indicates significant multicollinearity. This same conclusion is supported by Tavakol and Dennick (2011) and Gujarat (2009). A multicollinearity test was performed among the variables of the study and the results obtained are presented in Table 4.4. The results of this test show that there was no multicollinearity between the dependent and independent variables. Multicollinearity is usually present when VIF is above 10 and tolerance is below 0.1

Table 4.4: Testing for Multicollinearity

Model		Collinearity Statistics	
		Tolerance	VIF
1	Institutional Policies	.529	1.892
	Management Functions	.556	1.797
	Human Resource Management	.438	2.282
	Governance Systems	.494	2.026
	Financial Management Systems	.640	1.563

a. Dependent Variable: Transformation of MSMEs

4.2.9 Testing for Autocorrelation

Gujarat (2009) and Cameron (2005), both cited in Keraro (2014) defined autocorrelation as the correlation between members of a series of observations ordered in time or space. According to Gujarat (2009), the Durbin-Watson statistic ranges in value between 0 and 4. A value near 2 indicates non-autocorrelation; a value closer to 0 indicates positive correlation while a value closer to 4 indicates negative correlation.

This study conducted a Durbin-Watson test to detect the presence of autocorrelation between the dependent and independent variables. A Durbin Watson result of 1.856 was achieved as presented in Table 4.5. These results demonstrate that there was no autocorrelation between the dependent and independent variables since the Durbin-Watson coefficient was 1.856. A value near 2 indicates non-autocorrelation.

Table 4.5: Testing for Autocorrelation between Variables

Model	Durbin-Watson
1	1.856

a. Predictors: (Constant), Financial Management Systems, Institutional Policies, Management Functions, Governance Systems, Human Resource Management

b. Dependent Variable: Transformation of MSMEs

4.3 Results and Findings on the Dependent Variable, Transformation of MSMEs

4.3.1 Introduction

This section presents the findings and discussion on the dependent variable, transformation of MSMEs. Literature reviewed in chapter two revealed that MSMEs in Kenya and across Africa face many and varied challenges to their growth and operations ((Wanjohi, 2008 & 2009; UNIDO, 2002). These challenges range from inadequate office space, poor infrastructures, expensive internet connectivity, and inflexible lease terms to poor human skills. Image is important to transformed MSMEs (Njagi, 2011) as it means credibility. These organizations, therefore, require transformational growth. Transformation in this study therefore, looks at a process of profound and radical change that orients MSMEs in a new direction and takes it to an entirely different level of growth. This study sought responses on four key investigation issues relating to transformation of MSMEs and the findings and results are discussed in sections 4.3.2 to 4.3.7.

4.3.2 Reliability Test for Transformation of MSMEs

Reliability refers to the repeatability, stability or internal consistency of a questionnaire (Jack & Clarke, 1998). According to Sekaran (2008), Cooper and Schindler (2003), Cronbach's alpha has the most utility for multi-item scales at the interval level of measurement, requires only a single administration and provides a unique, quantitative estimate of the internal consistency of a scale.

The study carried out a reliability test on the dependent variable, Transformation of MSMEs. The results from this test are summarized in Table 4.6. The results indicate a Cronbach reliability alpha score of .807, which is higher than the recommended threshold of .7 alpha score.

Table 4.6: Reliability Test for Transformation of MSMEs

Reliability Statistics	
Cronbach's Alpha	N of Items
.807	4

4.3.3 Factor Analysis for Transformation of MSMEs

Factor analysis is a statistical method used to describe variability among observed, correlated variables in terms of a potentially lower number of unobserved variables called factors (Kothari, 2004; Cooper & Schindler, 2003). Kothari (2004) adds that factor analysis originated in psychometrics and is used in behavioural sciences, social sciences and other fields that deal with data sets where there are large numbers of observed variables that are thought to reflect a smaller number of underlying/latent variables.

A factor analysis was carried out to determine how various factors would load on Transformation of MSMEs. The findings summarized in Table 4.7 shows that all the factors loaded highly on the dependent variable (Transformation of MSMEs) as all of them had scores above the threshold of .4.

Table 4.7: Factor Analysis on the Dependent Variable (Transformation of MSMEs)

Component Matrix	
Research Item	Component
Our assets over the last 5 years enhanced transformation of MSMEs that we support	.821
The products and services we offer helped transform MSMEs of our clients	.801
Our positive Return on Investment (ROI) over the last 5 years has transformed the MSMEs we support	.796
Our MFI has experienced an increased number of transformed MSMEs in the last five (5) years	.779

Extraction Method: Principal Component Analysis

4.3.4 Descriptive Statistics for Transformation of MSMEs

Descriptive statistics is important because it enables us to present data in a meaningful way, and therefore allows for a simpler interpretation of the data in any form of research (Cooper & Schindler, 2003; Sekaran, 2008; Kothari, 2004). An analysis of the descriptive statistics on the dependent variable (Transformation of MSMEs) was carried out. Findings from the study were expressed as percentages and are summarized in Table 4.8.

Table 4. 8 Descriptive statistics for Transformation of MSMEs

Research Item	Strongly		Neutral	Strongly		Mean	Std. Deviation
	Disagree	Disagree		Agree	Agree		
Our MFI Institution has experienced an increased number of transformed MSMEs in the last five (5) years	0.0%	1.9%	7.4%	67.6%	23.1%	4.20	.508
Our improved assets base over the last 5 years has enhanced transformation of MSMEs that we support	0.0%	1.9%	10.2%	66.7%	21.3%	4.15	.534
Our positive Return on Investment (ROI) over the last 5 years has transformed the MSMEs we support	0.0%	4.6%	17.6%	53.7%	24.1%	4.06	.687
The products and services that we offer have contributed to the transformation of MSMEs owned by our clients	0.0%	1.9%	7.4%	57.4%	33.3%	4.31	.545

These results indicate that a majority of the respondents (67.6%) agreed that their MFI institution had experienced an increased number of transformed MSMEs in the last five (5) years, 66.7% agreed that their improved assets base over the last 5 years had enhanced transformation of MSMEs that they supported, 53.7% agreed that their positive return on investment (ROI) over the last 5 years had transformed the

MSMEs they supported, while 57.4% agreed that the products and services that they offer had contributed to the transformation of MSMEs owned by their clients. The standard deviation and mean achieved for all the research items are also presented in Table 4.8.

These findings corroborate literature by Khandker (2005), WB (2012, 2013) which concluded that Micro-financing gives MSMEs the means to exploit emerging opportunities and make them responsible for their own future. These authors argued that MFIs broaden the horizons of the business enterprises, thus playing both economic and social roles by improving the living conditions of the people involved. Institutions that operate under prudent regulations are, in most cases, required to transform institutionally so as to comply with set requirements (Sengupta & Aubuchon, 2008). The scholars aver that in most cases this transformation has involved change of legal status, ownership, organizational structures, systems and their delivery channels. This change has led to some of the challenges facing MFIs in transforming micro, small and medium enterprises to viable businesses in Kenya (Njihia, 2005). Based on the findings of this study, it is noted that a majority of the respondents (over 53.7%) agreed with all the four research questions put to them that, indeed, MFIs play a significant role in transforming the growth of MSMEs through the products and services they provide to them, the financial and asset base of the MFI provides a cushion on the vulnerabilities of the MSMEs

4.3.5 Normality Test on the Dependent Variable (Transformation of MSMEs)

An assessment of the normality of data is a prerequisite for many statistical tests because normal data is an underlying assumption in Classical Linear Regression Modelling (CLRM as well as parametric testing. A normality test is used to determine whether sample data has been drawn from a normally distributed population (within some tolerance) and that the data set is well-modelled by a normal distribution. It is also important as it enables a researcher to compute the likelihood of a random variable underlying the data set to be normally distributed (Cooper & Schindler, 2003).

A normality test on the dependent variable (Transformation of MSMEs) was carried out. A normal Q-Q plot of the data generated from the study was generated from the SPSS software. The normality test findings are summarized in Figure 4.5. From the figure, most of the scatter dots fall within the line of best fit and, therefore, the dependent variable was assumed to have a normal distribution.

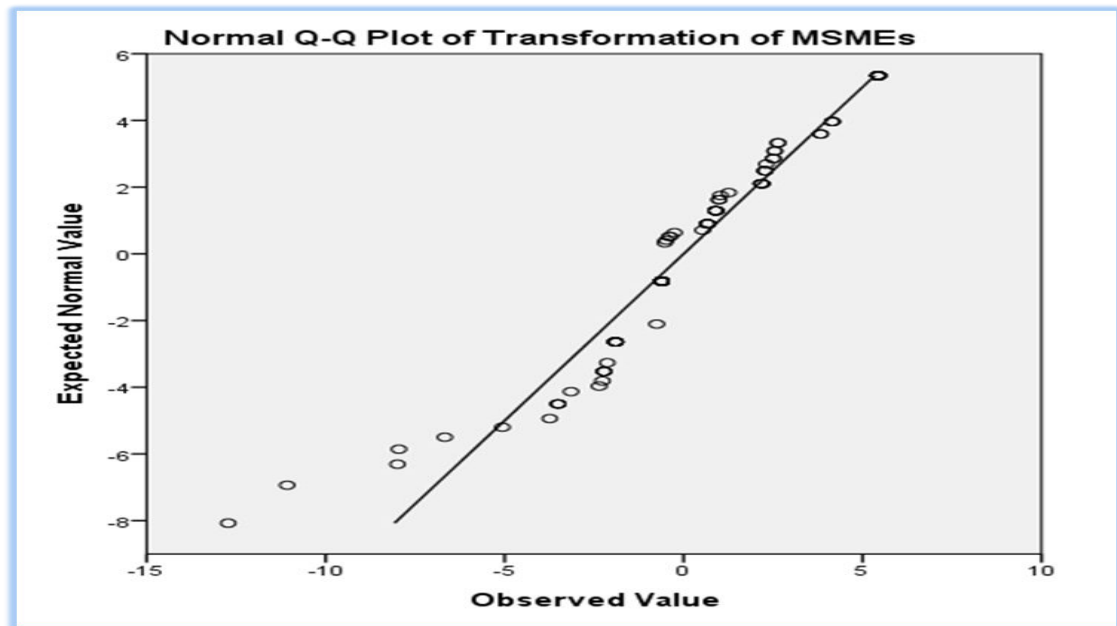


Figure 4.5: Normal Q-Q Plot on Dependent Variable

4.3.6 Checking for Outliers on Dependent

An outlier is an observation that is a long way from the general pattern of the distribution of a variable. It simply means that it “Lies Out” from the rest of the data. Presence of many outliers may give the impression that some observations are having “too much influence” on the results. The researcher sought out to establish if the dependent variable contained any outliers. A box plot was generated from the SPSS software and presented as Figure 4.6. The figure is observed to have no outliers as there are no scatter dots below and above the box plot.

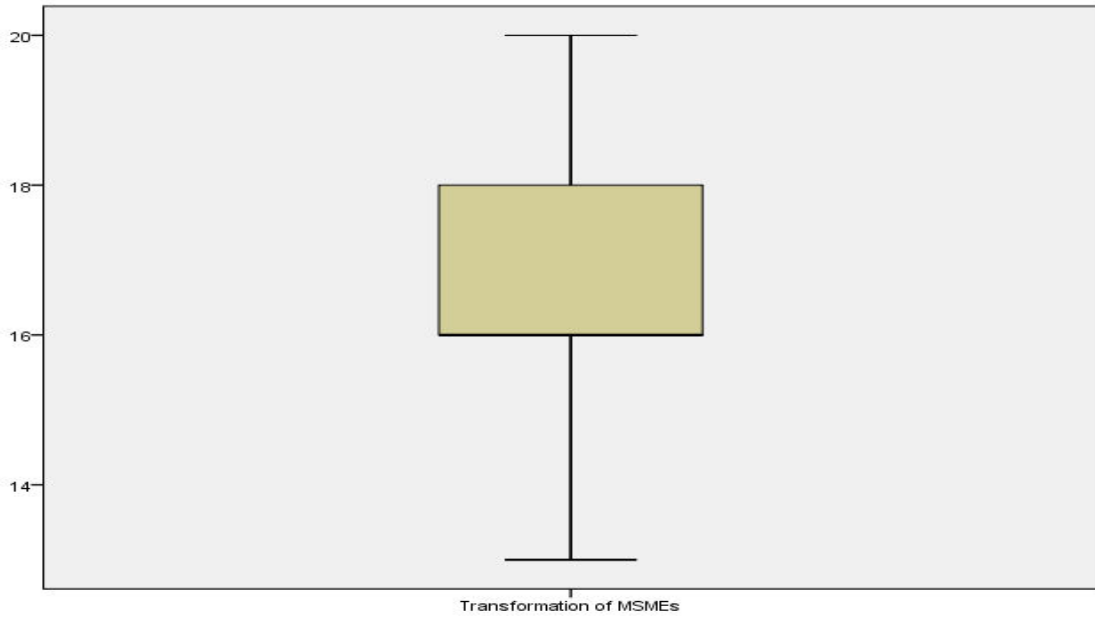


Figure 4.6: Box plot test on outliers of the dependent variable

4.3.7 Testing for Heteroscedasticity in the Dependent Variable

One of the Classical Linear Regression Model (CLRM) assumptions is that the error term variance being in any research data is constant. Homoscedasticity is therefore a term used to denote a statistical situation where the error has the same variance (when line of best fit is fitted) regardless of the value(s) taken by the independent variable(s). In many situations, the error term doesn't have a constant variance, thus leading to a condition referred to as heteroscedasticity; when the variance of the error term changes in response to a change in the value(s) of the independent variable(s). When the condition of heteroscedasticity is present, then the dispersion of the error changes over the range of observations, thus forming a systematic pattern in the research data analysis. Presence of heteroscedasticity is a serious matter that should be investigated before continuing to analyze the data.

The study conducted a test to check for the presence of heteroscedasticity (the opposite of homoscedasticity) on the dependent variable. A scatter diagram was generated from SPSS software and is presented in Figure 4.7. From the figure, the dependent variable (Transformation of MSMEs) can be said to have no presence of heteroscedasticity as the scatter dots do not form any systematic pattern.

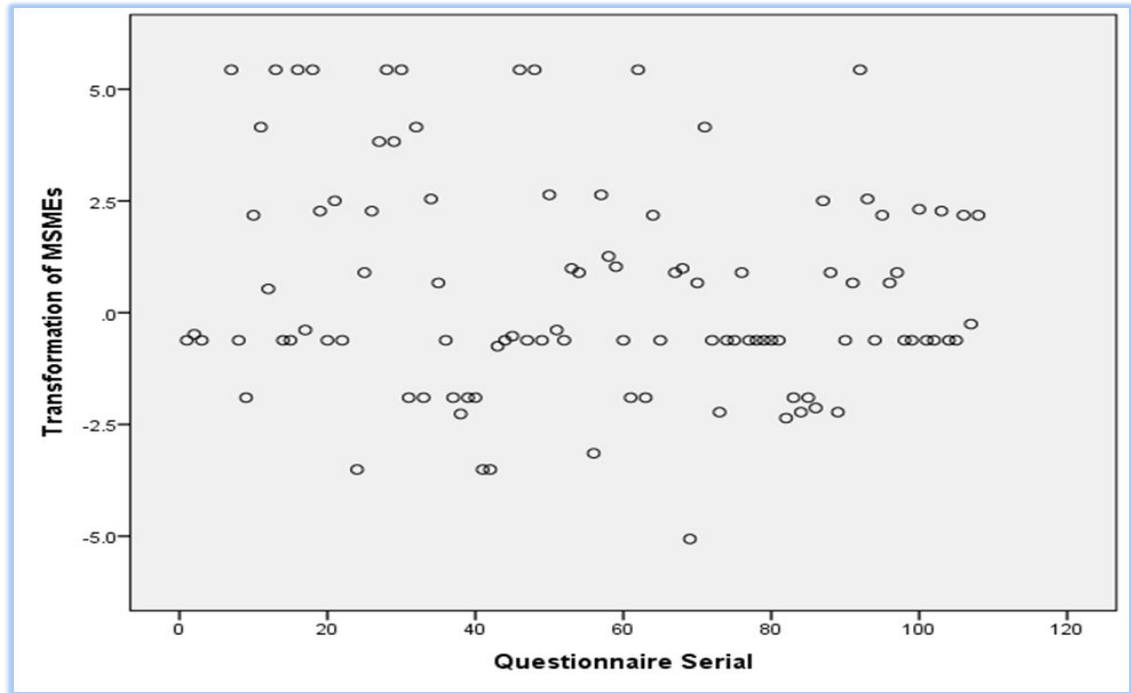


Figure 4.7: Scatter Diagram to illustrate Homoscedasticity in the dependent variable

4.4 Results and Findings on Influence of Institutional Policies

4.4.1 Introduction

Literature reviewed revealed that the main aim of institutional policy development for MSMEs is to focus on improving the business climate for MSMEs, with particular emphasis on addressing policies and regulations which create impediments to accessing and providing financing for MSMEs. Policy initiatives are developed in order to improve both the regulatory and business environments in the areas of corporate governance and remittances. EBRD (2006) and Dahiru and Zubair (2008) averred that by bringing these impediments to the attention of the relevant authorities, targets policy development efforts to contribute to an improvement in the environment both for individual MSMEs and the institutions which lend to them, the MFIs. This study sought for responses on five key investigation areas relating to institutional policies and transformation of MSMEs. The findings and results obtained from this investigation are discussed in sections 4.4.2 to 4.4.5 of this thesis.

4.4.2 Reliability Test for Institution Policies

According to Jack and Clarke (1998), Cooper and Schindler (2003) and Kothari (2004), reliability refers to the repeatability, stability or internal consistency of a questionnaire. According to Sekaran (2008), Cooper and Schindler (2003), Cronbach's alpha has the most utility for multi-item scales at the interval level of measurement, requires only a single administration and provides a unique, quantitative estimate of the internal consistency of a scale. A reliability test was carried out on Institution Policies of MFI's to establish their influence on the transformation of MSMEs in Kenya. The results from this test are summarized in Table 4.9. These results indicate that institution policies had a Cronbach reliability alpha score of .758 which is above and higher than the recommended threshold of .7 alpha score.

Table 4.9: Reliability Test on Institution Policies

Reliability Statistics	
Cronbach's Alpha	N of Items
.758	5

4.4.3 Factor Analysis for Institution Policies and Transformation of MSMEs

In research, factor analysis helps to describe variability among observed, correlated variables in terms of a potentially lower number of unobserved variables called factors (Kothari, 2004; Cooper and Schindler, 2003). A factor analysis was carried out on Institution Policies to establish how different factors load in relation to the transformation of MSMEs. The findings presented in Table 4.10 show that all the factors loaded highly as none had a score below the threshold of .4 and therefore none was eliminated from further analysis.

Table 4.10: Factor Analysis for Institution Policies

Component Matrix	
	Component 1
Our Institution requires that all the information gathered about our clients is passed on to the credit operations for review	.790
In this institution, written procedures and instructions are given a special importance with special focus on our MSMEs clients	.770
Our Institution collects comprehensive and current data on the economic and personal situation of the MSMEs	.727
Our Institution has a formal and written discipline policy to effectively support our MSMEs clients	.681
The credit operations unit does preliminary review of the completeness and consistency of the borrowers' data (MSMEs)	.590

Extraction Method: Principal Component Analysis.

4.4.4 Descriptive Statistics for Institution Policies

Descriptive statistics is important because it enables us to present data in a meaningful way, and therefore allows for a simpler interpretation of the data in any form of research (Cooper & Schindler, 2003; Sekaran, 2008; Kothari, 2004). An analysis of the descriptive statistics for Institution Policies was carried out and a descriptive statistics table was generated from SPSS Software and presented in form of percentages as shown in Table 4.11.

Influence of Institution policies on transformation of MSMEs

The study sought to determine the influence of institution policies of MFIs in transforming MSMEs. The results as illustrated in Table 4.11 indicated that a majority (59.8%) strongly agreed that their institution had a formal and written discipline policy to effectively support their MSMEs clients, 56.9% also strongly agreed that in their institution, written procedures and instructions are given a special importance with special focus on their MSMEs clients. A majority (46.1%) agreed that their institution collects comprehensive and current data on the economic and personal situation of the MSMEs, 54.9% strongly agreed that their institution requires that all the information gathered about their clients is passed on to the credit operations for review, while 68.6% strongly agreed that the credit operations unit does preliminary review of the completeness and consistency of the borrowers' data (MSMEs).

Table 4.11: Descriptive Statistics for Institution Policies

Research Item	Strongly		Neutral	Strongly		Mean	Std. Deviation
	Disagree	Disagree		Agree	Agree		
Our Institution has a formal and written discipline policy to effectively support our MSMEs clients	0.0%	1.0%	4.9%	34.3%	59.8%	4.53	.640
In this institution, written procedures and instructions are given a special importance with special focus on our MSMEs clients	0.0%	1.0%	4.9%	37.3%	56.9%	4.50	.641
Our Institution collects comprehensive and current data on the economic and personal situation of the MSMEs	1.0%	1.0%	16.7%	46.1%	35.3%	4.14	.797
Our Institution requires that all the information gathered about our clients is passed on to the credit operations for review	1.0%	3.9%	5.9%	34.3%	54.9%	4.38	.845
The credit operations unit does preliminary review of the completeness and consistency of the borrowers' data (MSMEs)	0.0%	1.0%	3.9%	26.5%	68.6%	4.63	.612

These results strongly corroborates with conclusions made by a number of authors whose literature has been reviewed, including EBRD (2006), and Dahiru and Zubair (2008) who said that institutional policy development for MSMEs is intended to focus on improving the business climate for MSMEs generally. These authors recommended that policy initiatives should be developed to improve both the regulatory and business environments in the areas of corporate governance and remittances. These results are also in agreement with conclusions reached by a study

conducted by Onyeagocha, Chidebelu, Okorji, Ukoha, Osuji and Korie (2012) in South East States of Nigeria that deliberate policies to institute formal segmentation led to more organized and better equipped MSMEs with higher quality and well motivated staff than the semi-formal and informal segments. This study also revealed that policies on outreach, risk management, training duration, loan size and credit officers experience, among others led to more effective transformation and growth of MSMEs in South East States in Nigeria. The standard deviation and mean achieved for all the research items are also presented in Table 4.11.

These results further concur with a study conducted by Taiwo (2012) which stated that micro-financing banks had a huge impact on welfare and poverty alleviation in South West States in Nigeria. The results also augment the findings of Gomez and Eric (2005) who carried out a study on 612 group borrowers and 52 individual borrowers in Canada, concluded that good policies on group lending and the presence of neighbours have a positive correlation with self-employment earnings, meaning that borrowers with higher earnings will have an easier time of servicing their microloans and performance of MFIs and SACCOs depends on the profile of their members.

These results indicate that all the questions raised were either agreed or strongly agreed with by the respondents. On the basis of these findings obtained, therefore, and relating them to the literature reviewed in chapter 2, the study strikes a strong affirmation that institutional policies of MFI's have a significant impact on the lives of entrepreneurs who often are the owners of the MSMEs in society. It can, therefore, be inferred that good MFI Institutional policies that touch on interest rates and other credit lending policies have a significant impact on the performance of MSME clients. It can also be averred from these results that lots of positive social benefits accrue from the development of strong MFI institutional policies.

4.4.5 Inferential Statistics for Institution Policies

4.4.5.1 Linearity Test between Institution Policies and Transformation of MSMEs

According to Osborne and Waters (2002), inferential statistical tests rely upon certain assumptions about the variables used in an analysis. A test of linearity is one such crucial test as it directly relates to the bias of the results of the whole analysis (Keith, 2006). Linearity defines the dependent variable as a linear function of the predictor (independent) variables (Darlington, 1968). Multiple regressions can accurately estimate the relationship between dependent and independent variables when the relationship is linear in nature (Osborne & Waters, 2002). The chance of non-linear relationships is high in the social sciences, therefore it is essential to examine analyses for linearity (Osborne & Waters, 2002). If linearity is violated all the estimates of the regression including regression coefficients, standard errors, and tests of statistical significance may be biased (Keith, 2006). If the relationship between the dependent and independent variables is not linear, the results of the regression analysis will under- or over- estimate the true relationship and increase the risk of Type I and Type II errors (Osborne & Waters, 2002). When bias occurs it is likely that it does not reproduce the true population values (Keith, 2006). Violation of this assumption threatens the meaning of the parameters estimated in the analysis (Keith, 2006).

The study sought to establish whether institution policies and transformation of MSMEs had a linear relationship between them. A curvilinear graph was generated from SPSS data and presented in Figure 4.10.

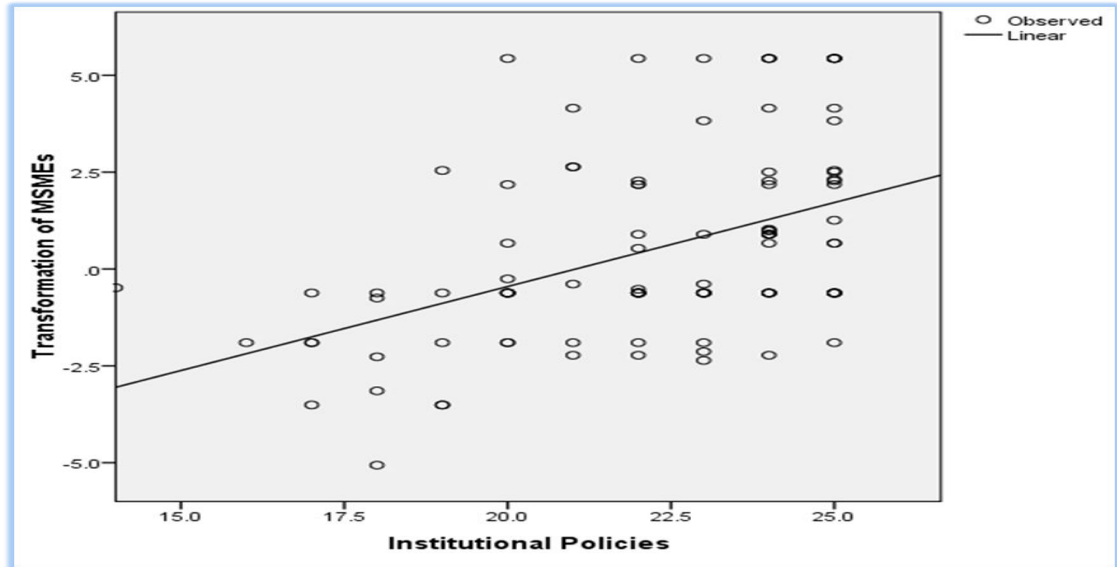


Figure 4.8: A curvilinear graph for Institution Policies and Transformation of MSMEs

This graph shows that the scatter dots fall within the curvilinear line. This implies that a positive linear relationship exist between Institution Policies and Transformation of MSMEs.

4.4.5.2 Correlation between Institutional Policies and Transformation of MSMEs

Pearson's correlation is used when you are working with two quantitative variables in a population. The possible research hypotheses are that the variables will show a positive linear relationship, a negative linear relationship, or no linear relationship at all (Keith, 2006; Stevens, 2009; Osborne & Waters, 2002). These authors argue that Pearson's correlation coefficients indicate the extent of interdependence between two variables. The Pearson correlation coefficient, r , can take a range of values from +1 to -1. A value of 0 indicates that there is no association between the two variables. A value greater than 0 indicates a positive association; that is, as the value of one variable increases, so does the value of the other variable (Stevens, 2009). A value less than 0 indicates a negative association; that is, as the value of one variable increases, the value of the other variable decreases

The study sought to establish whether there was correlation between institutional policies and transformation of MSMEs. The findings are summarized in Table 4.12

Table 4.12: Correlation between Institutional Policies and Transformation of MSMEs

		Correlations	
		Transformation of MSMEs	Institutional Policies
Transformation of MSMEs	of Pearson Correlation	1	.463**
	Sig. (2-tailed)		.000
	N	102	102
Institutional Policies	Pearson Correlation	.463**	1
	Sig. (2-tailed)	.000	
	N	102	102

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

These findings show a positive correlation coefficient of .463 or 46.3% was found to exist between institutional policies and the transformation of MSMEs.

4.4.5.3 Regression Analysis between Institutional Policies

Linear regression refers to a linear estimation of the relationship between a dependent variable and one or more independent variables. According to Jaccard *et al.*, (2006), regression analyses are usually driven by a theoretical or a conceptual model that can be drawn in the form of a path diagram. The path diagram provides the model for setting the regression and what statistics to exam. Multiple regression is widely used to estimate the size and significance of the effects of a number of independent variables on a dependent variable (Osborne & Waters, 2002). A regression analysis was carried out in order to determine whether the independent variable, institutional policies could be relied on in explaining the change in the dependent variable, the transformation of MSMEs in Kenya. The model summary of the regression coefficients findings are presented in Table 4.13.

Table 4.13: Model Summary for Institutional Policies and Transformation of MSMEs

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.463	.215	.207	1.453

a. Predictors: (Constant), Institutional Policies

The coefficients obtained indicate that the correlation coefficient (R) between the independent variable and the transformation of MSMEs in Kenya was .463 which is a positive correlation relationship. From Table 4.13, this variable achieved a coefficient of determination (R^2) of .215, which means that this variable alone can explain up to 21.5% of the total variability in the dependent variable, transformation of MSMEs in Kenya.

4.4.5.4 ANOVA for Institutional Policies

The acronym ANOVA refers to analysis of variance and is a statistical procedure used to test the degree to which two or more groups vary or differ in an experiment. ANOVA tests splits the aggregate variability found inside a data set into two parts: systematic factors and random factors (Jaccard *et al.*, 2006). In most experiments, a great deal of variance (or difference) usually indicates that there was a significant finding from the research. The systematic factors have a statistical influence on the given data set, but the random factors do not. Analysts use the analysis of the variance test to determine the result independent variables have on the dependent variable amid a regression study (Keith, 2006).

An ANOVA test was performed on the variable, institutional policies and the results obtained are summarized in Table 4.14.

Table 4.14: ANOVA Test for Institutional Policies and Transformation of MSMEs

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	57.721	1	57.721	27.352	.000
	Residual	211.034	100	2.110		
	Total	268.755	101			

From this Table, 4.12, the model is found to be statistically significant in explaining the change in the dependent variable, transformation of MSMEs as its p-value is less than .05. This means, therefore, that the null hypothesis that institutional policies do not have a statistically significant influence on the transformation of MSMEs is rejected and instead the alternative hypothesis that institutional policies have a statistically significant influence on the transformation of MSMEs is accepted.

The table shows that the variable has a P- value equals to .000, demonstrating that the model is statistically significant in explaining the change in the dependent variable, considering that the P-value is less than .05 at the 95% level of confidence. To compliment the findings on Institutional policies and transformation of MSMEs generated from the ANOVA test results, Person's correlation coefficients were also generated. The results of the person's correlation are presented in Table 4.15. These results show that institutional policies contribute a statistically significant value (p-value = .000) of .297 to the regression model.

Table 4.15: Coefficient for Institutional Policies and Transformation of MSMEs

Model		Unstandardized		Standardized		
		Coefficients		Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	10.121	1.269		7.976	.000
	Institutional Policies	.297	.057	.463	5.230	.000

Using the summary presented in Table 4.15, a linear regression model of the form, $Y = \alpha + \beta X_i$ can be fitted as follows:

$$Y = 10.121 + 0.297X_i + e \dots\dots\dots \text{Equation 1}$$

4.5 Results and Findings on Influence of Management Functions

4.5.1 Introduction

As already discussed in the literature review section of this study, putting up proper managerial structures and processes in organizations is always a necessity during any institutional development processes. Dirk and Achterbergh (2011), Fischer (2006) and Mullins (2010) all cited in Keraro (2014) held the view that developing management structures that permit institutions to attenuate and amplify talent is a crucial condition for organizational viability. Keraro (2014) contends that modern day clamour for lean management structures derive their justification from the fact that they facilitate faster strategic decision making. This study sought for responses on six key investigation areas relating to managerial functions and the transformation of MSMEs. Results obtained from this investigate are discussed in sections 4.5.2 to 4.5.5 of this thesis.

4.5.2 Reliability Test on Management Functions

According to Jack and Clarke (1998) reliability refers to the repeatability, stability or internal consistency of a questionnaire. According to Sekaran (2008), Cooper and Schindler (2003), Cronbach's alpha has the most utility for multi-item scales at the interval level of measurement, requires only a single administration and provides a unique, quantitative estimate of the internal consistency of a scale. A reliability test was carried out on managerial functions of MFIs to establish their influence on the transformation of MSMEs in Kenya. The results from this test are summarized in Table 4.16. These results indicate that Management Functions had a Cronbach reliability alpha score of .801 which is above higher than the recommended threshold of .7 alpha score.

Table 4.16 Reliability Test on Management Functions

Reliability Statistics	
Cronbach's Alpha	N of Items
.801	6

4.5.3 Factor Analysis on Management Functions

Factor analysis is a statistical method used to describe variability among observed, correlated variables in terms of a potentially lower number of unobserved variables called factors (Kothari, 2004; Cooper & Schindler, 2003). A factor analysis was carried out on managerial functions to establish how different factors load in relation to the transformation of MSMEs. The findings presented in Table 4.17 show that all the factors loaded highly as none had a score below the threshold of .4 and therefore none was eliminated from further analysis.

Table 4.17: Factor Analysis on Management Functions

Component Matrix	
	Component
	1
There are well trained and experienced employees in the organization who deliver high quality service to our customers (the MSMEs)	.794
Managers in our organization take action on new and innovative ideas provided by employees to improve support to our clients	.751
There is effective communication within our organization and with our clients (the MSMEs)	.732
Our management team is easily accessible by our clients (MSMEs) on business related issues	.731
There is clear division of duties and responsibility among employees with a clear focus on enhanced service delivery to our clients	.647
Our organization's operations are always based on the developed strategic plan, with a specific focus on enhanced service to our customers	.577

Extraction Method: Principal Component Analysis.

4.5.4 Descriptive Statistics on Management Functions

Descriptive statistics is important because it enables us to present data in a meaningful way, and therefore allows for a simpler interpretation of the data in any form of research (Cooper & Schindler, 2003; Sekaran, 2008; Kothari, 2004). An analysis of the descriptive statistics for managerial Functions was carried out and a descriptive statistics table was generated from SPSS Software and presented in form of percentages as shown in Table 4.18.

Influence of Management Functions on transformation of MSMEs

The study sought to investigate the influence of management functions in transforming MSMEs. The results on all the six questions raised as illustrated in Table 4.18 indicated that 54.9% of the respondents agreed that there is clear division of duties and responsibility among employees with a clear focus on enhanced service delivery to their clients, while 53.9% agreed that there is effective communication within their organization and with their clients (the MSMEs). A majority (52.9%) of the respondents agreed that there are well trained and experienced employees in the organization who deliver high quality service to their customers (the MSMEs), 56.9% strongly agreed that their organizations' operations are always based on the developed strategic plan, with a specific focus on enhanced service to their customers, 48.0% agreed that managers in their organizations take action on new and innovative ideas provided by employees to improve support to their clients, while 52.0% agreed that their management team is easily accessible by their clients (MSMEs) on business related issues.

Table 4.18: Descriptive Statistics on Managerial Functions

Research Item	Strongly		Neutral	Strongly		Mean	Std. Deviation
	Disagree	Disagree		Agree	Agree		
There is clear division of duties and responsibility among employees with a clear focus on enhanced service delivery to our clients	0.0%	2.0%	11.8%	54.9%	31.4%	4.16	.700
There is effective communication within our organization and with our clients (the MSMES)	0.0%	1.0%	28.4%	53.9%	16.7%	3.86	.690
There are well trained and experienced employees in the organization who deliver high quality service to our customers (the MSMEs)	1.0%	2.0%	11.8%	52.9%	32.4%	4.14	.771
Our organization's operations are always based on the developed strategic plan, with a specific focus on enhanced service to our customers	0.0%	1.0%	5.9%	36.3%	56.9%	4.49	.656
Managers in our organization take action on new and innovative ideas provided by employees to improve support to our clients	1.0%	2.0%	28.4%	48.0%	20.6%	3.85	.801
Our management team is easily accessible by our clients (MSMEs) on business related issues	0.0%	2.0%	16.7%	52.0%	29.4%	4.09	.733

These results strongly resonate with the literature reviewed the works of Dirk and Achterbergh (2011), Fischer (2006) and Mullins (2010 that failure of management to carry out the functions of planning, organizing, staffing, directing and controlling leads to lack of clear understanding of the organizational strategy. These authors concurred that developing management structures that permit institutions to attenuate and amplify talent is a crucial condition for organizational viability (Keraro, 2014). Poor communication is a sign of poor leadership and weak management (Aaltonen & Ikavalko, 2005). These authors argued that a great amount of information in organizations does not guarantee understanding of the management functions and strategy. The findings on the issue of communication confirm the findings by Wang (2004) who argued that communication should be two way so that it can provide information to improve understanding and responsibility and to motivate staff, thus leading to transformation of institutions. Effective communication should, therefore, be seen as a continuous activity throughout the life of the organization if these organizations have to be of any transformative value to the MSMEs. These results also are in tandem with the findings of Nave (2006) that the success or failure of an entity depends on the leadership styles employed by the leaders. Van Wart (2006) stated that organizations require efficient leaders who are capable of steering people in the right direction to achieve its mission, vision, and to remain faithful to the philosophy and values of the organization. The standard deviation and mean achieved for all the research items are also presented in Table 4.18.

The empirical results from this study, thus amplify the fact that MFIs whose managers exercise better management functions are more likely to spur transformation if the MSMEs that they work with than these that have weak management systems. Management capability in this case can be greatly influenced by a person's intelligence, physical ability and level of education. Managers in MFIs that recognize and take positive action on new and innovative ideas provided by their employees significantly contribute to the transformation of their clients, the MSMEs, in the same way managers who are easily accessible by their clients do.

4.5.5 Inferential Statistics for Management Functions

4.5.5.1 Linearity Test for Management Functions

A test of linearity is one such crucial test as it directly relates to the bias of the results of the whole analysis (Keith, 2006). Linearity defines the dependent variable as a linear function of the predictor (independent) variables (Darlington, 1968). Multiple regressions can accurately estimate the relationship between dependent and independent variables when the relationship is linear in nature (Osborne & Waters, 2002). The study sought to establish whether management functions and transformation of MSMEs had a linear relationship between them. A curvilinear graph was generated from SPSS data and presented in Figure 4.9 of this thesis.

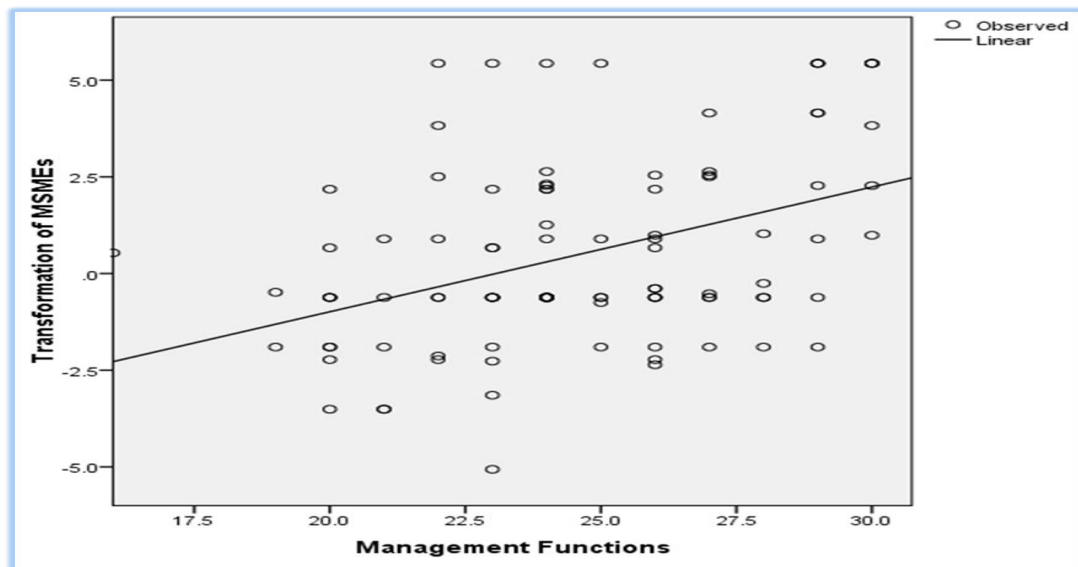


Figure 4.9: A curvilinear graph for Management Functions and Transformation of MSMEs

The figure 4.9 shows that the scatter dots fall within the curvilinear line which implies that a positive linear relationship exist between management functions and Transformation of MSMEs as most of the scatter dots lie within or close to the line.

4.5.5.2 Correlation between Management Functions and Transformation of MSMEs

Pearson's correlation is used when you are working with two quantitative variables in a population. The possible research hypotheses are that the variables will show a positive linear relationship, a negative linear relationship, or no linear relationship at all (Keith, 2006; Stevens, 2009; Osborne & Waters, 2002). These authors argue that Pearson's correlation coefficients indicate the extent of interdependence between two variables. The Pearson correlation coefficient, r , can take a range of values from +1 to -1. A value of 0 indicates that there is no association between the two variables. A value greater than 0 indicates a positive association; that is, as the value of one variable increases, so does the value of the other variable (Stevens, 2009). A value less than 0 indicates a negative association; that is, as the value of one variable increases, the value of the other variable decreases. This study sought to establish whether there was correlation between management functions and transformation of MSMEs. The findings are summarized in Table 4.19. From the table, a positive Pearson correlation coefficient of .395 or 39.5% was found to exist between management functions and the transformation of MSMEs.

Table 4.19: Correlation between Managerial Functions and Transformation of MSMEs

		Correlations	
		Transformation of MSMEs	Management Functions
Transformation of MSMEs	Pearson Correlation	1	.395**
	Sig. (2-tailed)		.000
	N	102	102
Management Functions	Pearson Correlation	.395**	1
	Sig. (2-tailed)	.000	
	N	102	102

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

4.5.5.3 Regression Analysis for Management Functions

Linear regression refers to a linear estimation of the relationship between a dependent variable and one or more independent variables. According to Jaccard *et al.*, (2006), regression analyses are usually driven by a theoretical or a conceptual model that can be drawn in the form of a path diagram. The path diagram provides the model for setting the regression and what statistics to exam. Multiple regression is widely used to estimate the size and significance of the effects of a number of independent variables on a dependent variable (Osborne & Waters, 2002).

A regression analysis was carried out in order to determine whether the independent variable, management functions could be relied on in explaining the change in the dependent variable, the transformation of MSMEs in Kenya. The model summary of the regression coefficients findings are presented in Table 4.20. The coefficients obtained indicate that the correlation coefficient (R) between the independent variable and the transformation of MSMEs in Kenya was .395 which is a positive correlation relationship. From Table 4.20, this variable achieved a coefficient of determination (R^2) of .156, which means that this variable alone can explain up to 15.6% of the total variability in the dependent variable, transformation of MSMEs in Kenya. .

Table 4.20: Model Summary for Management Functions and Transformation of MSMEs

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.395 ^a	.156	.148	1.506

a. Predictors: (Constant), Management Functions

4.5.5.4 ANOVA Test for Management Functions

The acronym ANOVA refers to analysis of variance and is a statistical procedure used to test the degree to which two or more groups vary or differ in an experiment. ANOVA tests splits the aggregate variability found inside a data set into two parts:

systematic factors and random factors (Jaccard *et al.*, (2006). In most experiments, a great deal of variance (or difference) usually indicates that there was a significant finding from the research. The systematic factors have a statistical influence on the given data set, but the random factors do not. Analysts use the analysis of the variance test to determine the result independent variables have on the dependent variable amid a regression study (Keith, 2006).

An ANOVA test was performed on the variable, management functions and the results obtained are summarized in Table 4.21. From this Table, 4.21, the model is found to be statistically significant in explaining the variability in the dependent variable, transformation of MSMEs as its p-value is less than .05 threshold. This means, therefore, that the null hypothesis that management functions do not have a statistically significant influence on the transformation of MSMEs is rejected and instead the alternative hypothesis that they have a statistically significant influence on the transformation of MSMEs is accepted. Table 4.21 shows that the variable has a P- value equals to .000, demonstrating that the model is statistically significant in explaining the change in the dependent variable, considering that the P-value is less than .05 at the 95% level of confidence.

Table 4.21: ANOVA for Management Functions and Transformation of MSMEs

		ANOVA				
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	41.991	1	41.991	18.517	.000
	Residual	226.764	100	2.268		
	Total	268.755	101			

To compliment the findings on management functions and transformation of MSMEs generated from the ANOVA test results, Person's correlation coefficients were also generated. The results of the person's correlation are presented in Table 4.22. These results show that management functions contribute a statistically significant value (p-value = .000) of .209 to the regression model.

Table 4.22: Coefficients for Management Functions and Transformation of MSMEs

Model		Unstandardized		Standardized		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	11.580	1.203		9.629	.000
	Management Functions	.209	.049	.395	4.303	.000

Using the summary presented in Table 4.22, a linear regression model of the form, $Y = \alpha + \beta X_i$ can be fitted as follows:

$$Y = 11.580 + 0.209X_2 + e \dots\dots\dots \text{Equation 2}$$

4.6 Results and Findings on Influence Human Capacity Development

4.6.1 Introduction

In the literature review section of this thesis, it has been argued that human resource is the most important asset for any organization that has been directly linked to the successful growth of many leading organizations. Examples were given such as Google that have good HRM practices in place and has made the institution one of the greatest companies to work for and managed to retain their best talents. Transformed organizations manage their businesses through their employees and the

human resource function is about creating the conditions that allow employees to do their best on behalf of the enterprise. This study sought for responses on five key investigation areas relating to human capacity development and the transformation of MSMEs. Results obtained from this investigation are discussed in sections 4.6.2 to 4.6.5 of this thesis.

4.6.2 Reliability Test on Human Capacity Development

According to Jack and Clarke (1998) reliability refers to the repeatability, stability or internal consistency of a questionnaire. According to Sekaran (2008), Cooper & Schindler (2003), Cronbach's alpha has the most utility for multi-item scales at the interval level of measurement, requires only a single administration and provides a unique, quantitative estimate of the internal consistency of a scale. A reliability test was carried out on human capacity development of MFI's to establish their influence on the transformation of MSMEs in Kenya. The results from this test are summarized in Table 4.23. These results indicate that Human Capacity Development had a Cronbach reliability alpha score of .775 which is above and higher than the recommended threshold of .7 alpha score.

Table 4.23: Reliability test on Human Capacity Development

Reliability Statistics	
Cronbach Alpha	N of Items
.775	5

4.6.3 Factor Analysis on Human Capacity Development

Factor analysis is a statistical method used to describe variability among observed, correlated variables in terms of a potentially lower number of unobserved variables called factors (Kothari, 2004; Cooper & Schindler, 2003). A factor analysis was carried out on human capacity development to establish how different factors load in relation to the transformation of MSMEs. The findings presented in Table 4.24 show

that all the factors loaded highly as none had a score below the threshold of .4 and therefore none was eliminated from further analysis.

Table 4.24: Factor Analysis on Human Capacity Development

Component Matrix	
	Component
	1
Our organization selects employees who can provide ideas to improve the operation process and adequately support our MSMEs clients	.813
Our organization selects employees who are able to work well in work teams and effectively support our MSMEs clients	.801
Incentive system in our organization rewards staff that accomplish work objectives with high satisfaction to clients	.758
Training currently provided in our institution has transformative effects on the transformation of MSMEs that we serve	.679
Our organization uses problem – solving aptitude and customer service as key criteria in employee selection	.587

Extraction Method: Principal Component Analysis.

4.6.4 Descriptive Statistics on Human Capacity Development

Descriptive statistics is important because it enables us to present data in a meaningful way, and therefore allows for a simpler interpretation of the data in any form of research (Cooper & Schindler, 2003; Sekaran, 2008; Kothari, 2004). An analysis of the descriptive statistics for Human Capital Development was carried out and a descriptive statistics table was generated from SPSS software. The results generated are presented in form of percentages as shown in Table 4.25.

Influence of human capacity development on transformation of MSMEs

The study sought to establish the influence of human capacity development by MFIs in transforming MSMEs. The results on all the five questions raised as illustrated in Table 4.25 showed that 48.0% of the respondents agreed that their organizations used problem solving aptitude and customer service as key criteria in employee selection, while 41.2% remained neutral on incentive system in their organization rewards staff that accomplished work objectives with high satisfaction to clients. A majority of 55.9% agreed that their organizations selected employees who could provide ideas to improve the operational processes and adequately supported their MSMEs clients, 59.8% agreed that their organization selects employees who were able to work well in teams and effectively supported their MSMEs clients, while 53.9% agreed that training provided in their institutions had transformative effects on the MSMEs that they served.

Responses to four out of the five questions raised generated results that corroborate most of the literature reviewed in relation to human capacity development as detailed in chapter 2. These results resonate with empirical findings of Sambhaji (2010) who studied high performance organizational HR practices in selected private sector milk processing organizations in western Maharashtra India and found out that in order for an organization to perform at an excellent level, top management had developed scientific HR policies and that these organizations were well versed with the HRD concept. The results from this study further agree with the works of Huselid (1995), Lin and Chen (2007), and Sanchez, Jimenez, Carnicer, and Perez (2007) who concluded that good HRM practices have significant positive impact on the organization's performance innovation and therefore, are directly linked better performance their institutions.

Table 4.25: Descriptive Statistics on Human Capacity Development

Research Item	Strongly		Neutral	Strongly		Mean	Std. Deviation
	Disagree	Disagree		Agree	Agree		
Our organization uses problem – solving aptitude and customer service as key criteria in employee selection	0.0%	1.0%	35.3%	48.0%	15.7%	3.78	.712
Incentive system in our organization rewards staff that accomplish work objectives with high satisfaction to clients	2.9%	4.9%	41.2%	36.3%	14.7%	3.55	.908
Our organization selects employees who can provide ideas to improve the operation process and adequately support our MSMEs clients	0.0%	3.9%	16.7%	55.9%	23.5%	3.99	.751
Our organization selects employees who are able to work well in work teams and effectively support our MSMEs clients	0.0%	1.0%	12.7%	59.8%	26.5%	4.12	.649
Training currently provided in our institution has transformative effects on the transformation of MSMES that we serve	0.0%	1.0%	19.6%	53.9%	25.5%	4.04	.702

These findings also corroborate the contributions by Julien and Ramangalahy (2003) who argued that organizations significantly dependent on capabilities and abilities of the firm’s managers and employees to plan for and adapt to the business environment in which they operate. Khandker (2005) and Banerjee and Duflo (2010) identified a positive relationship between a homogeneous collection of organizational capabilities and small business performance, as well as a more heterogeneous set of practices associated with average performance of small firms. These results further

buttress conclusions from a study by Kariuki (2006) conducted a study on the effects of human resource management strategies on the effectiveness of coffee marketing organizations in Meru in Kenya and concluded that human resource strategies affected the performance of the employees directly translating to the performance of the organization as a whole. The standard deviation and mean achieved for all the research items are also presented in Table 4.25.

It should be observed from the results contained in Table 4.25 that while responses to 4 out of the five questions turned in answers that were either agreed or strongly agreed, one of the questions turned in a lukewarm neutral answer. Respondents were asked whether there were incentives systems in place to reward staff that accomplished work objectives with high satisfaction levels to client MSMEs, a rather lukewarm response of neutral was obtained. This lays strong emphasis that you cannot de-link high quality support from transformation of MSMEs if attractive rewards systems are not in place. King (2009), whose study was reviewed, conducted a research to examine human resource practices and the impact of incentives and reward systems on manufacturing companies in Malaysia and he concluded that training and information technologies had a direct impact on organizational performance. He argued that incentive schemes positively related to organizational performance.

4.6.5 Inferential Statistics for Human Capacity Development

4.6.5.1 Linearity Test for Human Capacity Development

The study sought to establish whether human capacity development and transformation of MSMEs had a linear relationship between them. A curvilinear graph was generated from SPSS data and presented in Figure 4.10 of this thesis. The figure shows that the scatter dots fall within the curvilinear line which implies that a positive linear relationship exist between human capacity development and transformation of MSMEs as most of the scatter dots lie within or close to the line of best fit.

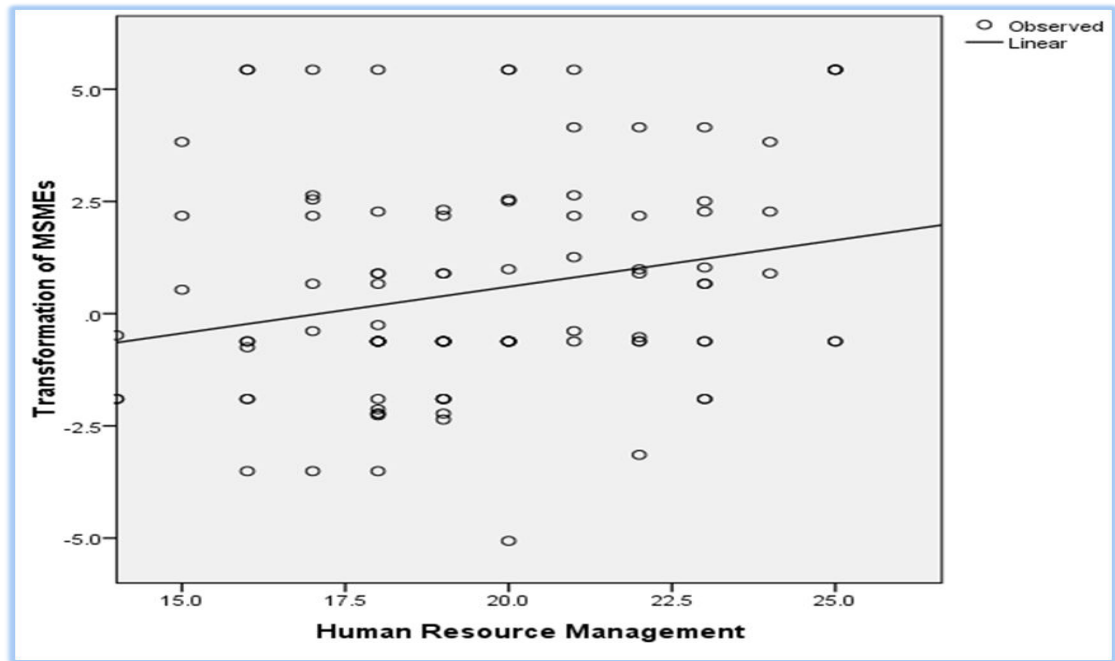


Figure 4.10: A curvilinear graph for Human Capacity Development

4.6.5.2 Correlation between Human Capacity Development and Transformation of MSMEs

Pearson's correlation is used when you are working with two quantitative variables in a population. The possible research hypotheses are that the variables will show a positive linear relationship, a negative linear relationship, or no linear relationship at all (Keith, 2006; Stevens, 2009; Osborne & Waters, 2002). These authors argue that Pearson's correlation coefficients indicate the extent of interdependence between two variables. The Pearson correlation coefficient, r , can take a range of values from +1 to -1. Pearson's Correlation coefficients indicates the extent of interdependence between two variables. This study sought to establish whether there was correlation between human capacity development and transformation of MSMEs. The findings are summarized in Table 4.26. From the table, a positive Pearson correlation coefficient of .227 or 22.7% was found to exist between human capacity development and the transformation of MSMEs.

Table 4.26: Correlation between Human Capacity Development and Transformation of MSMEs

		Correlations	
		Transformation of MSMEs	Human Resource Management
Transformation of MSMEs	Pearson Correlation	1	.227*
	Sig. (2-tailed)		.022
	N	102	102
Human Resource Management	Pearson Correlation	.227*	1
	Sig. (2-tailed)	.022	
	N	102	102

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

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

4.6.5.3 Regression Analysis for Human Capacity Development

Linear regression refers to a linear estimation of the relationship between a dependent variable and one or more independent variables. According to Jaccard *et al.*, (2006), regression analyses are usually driven by a theoretical or a conceptual model that can be drawn in the form of a path diagram. The path diagram provides the model for setting the regression and what statistics to exam. Multiple regression is widely used to estimate the size and significance of the effects of a number of independent variables on a dependent variable (Osborne & Waters, 2002).

A regression analysis was carried out in order to determine whether the independent variable, human capacity development could be relied on in explaining the change in the dependent variable, the transformation of MSMEs in Kenya. The model summary of the regression coefficients findings are presented in Table 4.27. The coefficients obtained indicate that the correlation coefficient (R) between the independent variable and the transformation of MSMEs in Kenya was .227 which is a positive correlation relationship. From Table 4.27, this variable achieved a coefficient of determination (R^2) of .052, which means that this variable alone can explain up to

5.2% of the total variability in the dependent variable, transformation of MSMEs in Kenya. .

Table 4.27: Model Summary of Human Capacity Development and Transformation of MSMEs

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.227 ^a	.052	.042	1.596

a. Predictors: (Constant), Human capacity Development

4.6.5.4 ANOVA Test for Human Capacity Development

The acronym ANOVA refers to analysis of variance and is a statistical procedure used to test the degree to which two or more groups vary or differ in an experiment. ANOVA tests splits the aggregate variability found inside a data set into two parts: systematic factors and random factors (Jaccard *et al.*, (2006). In most experiments, a great deal of variance (or difference) usually indicates that there was a significant finding from the research. The systematic factors have a statistical influence on the given data set, but the random factors do not. Analysts use the analysis of the variance test to determine the result independent variables have on the dependent variable amid a regression study (Keith, 2006).

An ANOVA test was performed on the variable, human capacity development and the results obtained are summarized in Table 4.28. From this Table, 4.28, the model is found to be statistically significant in explaining the variability in the dependent variable, transformation of MSMEs as its p-value is less than .05 threshold. This means, therefore, that the null hypothesis that human capacity development does not have a statistically significant influence on the transformation of MSMEs is rejected and instead the alternative hypothesis that it has a statistically significant influence on the transformation of MSMEs is accepted. Table 4.28 shows that the variable has a P- value equals to .000, demonstrating that the model is statistically significant in explaining the change in the dependent variable, considering that the P-value is less than .05 at the 95% level of confidence.

Table 4.28: ANOVA for Human Capacity Development and Transformation of MSMEs

ANOVA						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	13.900	1	13.900	5.454	.022 ^b
	Residual	254.855	100	2.549		
	Total	268.755	101			

To compliment the findings on human capacity development and transformation of MSMEs generated from the ANOVA test results, Person's correlation coefficients were also generated. The results of the person's correlation are presented in Table 4.29. These results show that human capacity development contributes a statistically significant value (p-value = .000) of .136 to the regression model.

Table 4.29: Coefficients for Human Capacity Development and Transformation of MSMEs

Model		Unstandardized Coefficients		Standardized Coefficients		Sig.
		B	Std. Error	Beta	T	
1	(Constant)	14.059	1.148		12.242	.000
	Human Resource Management	.136	.058	.227	2.335	.022

Using the summary presented in Table 4.29, a linear regression model of the form, $Y = \alpha + \beta X_i$ can be fitted as follows:

$$Y = 14.059 + 0.136X_3 + e \dots\dots\dots \text{Equation 3}$$

4.7 Results and Findings on Influence of Governance Systems

Empirical literature reviewed revealed that corporate governance in most micro-financing institutions is weak and the structure often represents the interests of the owners with little regards to the other stakeholders. Opening up governance of family-owned rural banks, cooperatives and NGOs to bring on board members who have banking expertise and improve quality in the MFI boards was identified as a challenge (Valentinov, 2007) in the Philippines. The other challenge noted from the literature reviewed was that of the selection criteria adopted for the board and senior management to facilitate the transformation of the MSMEs (Lauer, 2008). Therefore, for corporate governance to be effective in its transformative bid in spurring the growth of MSMEs, it is important that all directors understand how value can be added in the business and hence MFI directors need to undergo corporate governance training regularly so as to keep abreast with changes that occur in business to enable them appreciate their role in transforming the MSMEs. This study sought for responses on six key investigation areas relating to governance systems and the transformation of MSMEs. Results obtained from this investigation are discussed in sections 4.7.2 to 4.7.5 of this thesis.

4.7.1 Reliability Test on Governance Systems

According to Jack and Clarke (1998) reliability refers to the repeatability, stability or internal consistency of a questionnaire. According to Sekaran (2008), Cooper and Schindler (2003), Cronbach's alpha has the most utility for multi-item scales at the interval level of measurement, requires only a single administration and provides a unique, quantitative estimate of the internal consistency of a scale. A reliability test was carried out on governance systems of MFIs to establish their influence on the transformation of MSMEs in Kenya. The results from this test are summarized in Table 4.30. These results indicate that the Governance Systems had a Cronbach reliability alpha score of .847 which is above and higher than the recommended threshold of .7 alpha score.

Table 4.30: Reliability test on Governance System

Reliability Statistics	
Cronbach's Alpha	N of Items
.847	6

4.7.2 Factor Analysis on Governance System

Factor analysis is a statistical method used to describe variability among observed, correlated variables in terms of a potentially lower number of unobserved variables called factors (Kothari, 2004; Cooper & Schindler, 2003). A factor analysis was carried out on governance systems to establish how different factors load in relation to the transformation of MSMEs. The findings presented in Table 4.31 show that all the factors loaded highly as none had a score below the threshold of .4 and therefore none was eliminated from further analysis.

Table 4.31: Factor analysis for Governance System

Component Matrix	
	Component
	1
The board decisions have impacted positively on the transformation of MSMEs	.885
Board sub-committees have led to better organizational performance	.861
The Board is composed of directors with varied and relevant knowledge and skills to the MFI industry and MSMEs sector	.849
There is proper coordination and communication among the Board of Directors and with our clients	.761
Our Institution has an overall board and independent board subcommittees in place to enhance effective monitoring and oversight capable of enhancing the transformation of MSMEs	.672
Our Institution has board committees which consist of independent non-executives directors	.575

Extraction Method: Principal Component Analysis.

4.7.3 Descriptive Statistics on Governance Systems

Descriptive statistics is important because it enables us to present data in a meaningful way, and therefore allows for a simpler interpretation of the data in any form of research (Cooper & Schindler, 2003; Sekaran, 2008; Kothari, 2004). An analysis of the descriptive statistics for governance systems was carried out and a descriptive statistics table was generated from SPSS software. The results obtained are presented in form of percentages as shown in Table 4.32.

Influence of Governance systems on transformation of MSMEs

The study sought to examine the influence of Governance systems in MFIs in transforming MSMEs. The results on all the six questions raised as illustrated in Table 4.32 showed that 74.5% of the respondents strongly agreed that their institutions had an overall board and independent subcommittees in place for effective monitoring and oversight capable of enhancing the transformation of MSMEs, 68.6% strongly agreed that their institutions had board committees which consisted of independent non-executives directors, while 65.7% strongly agreed that board sub-committees had led to better organizational performance that by extension has led to the transformation of their MSMEs clients. A majority of 57.8% strongly agreed that there was proper coordination and communication among the board of directors and with their clients, 68.6% strongly agreed that the board was composed of directors with varied and relevant knowledge and skills to the micro-financing industry and MSMEs sector, while 66.7% strongly agreed that the board decisions had impacted positively on the transformation of MSMEs.

Table 4.32: Descriptive Statistics for Governance System

Research Item	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree	Mean	Std. Deviation
Our Institution has an overall board and independent board subcommittees in place to enhance effective monitoring and oversight capable of enhancing the transformation of MSMEs	0.0%	1.0%	2.9%	21.6%	74.5%	4.70	.577
Our Institution has board committees which consist of independent non-executives directors	1.0%	2.9%	7.8%	19.6%	68.6%	4.52	.841
Board sub-committees have led to better organizational performance that by extension has led to the transformation of our MSMEs clients	0.0%	0.0%	10.8%	23.5%	65.7%	4.55	.684
There is proper coordination and communication among the Board of Directors and with our clients	2.0%	4.9%	17.6%	17.6%	57.8%	4.25	1.038
The Board is composed of directors with varied and relevant knowledge and skills to the micro-financing industry and MSMEs sector	0.0%	0.0%	10.8%	20.6%	68.6%	4.58	.681
The board decisions have impacted positively on the transformation of MSMEs	0.0%	0.0%	10.8%	22.5%	66.7%	4.56	.683

These high ratings of the results obtained reinforce and conform with the arguments raised in the literature reviewed on the works of Lauer (2008), Keskin (2006) and Kyereboah-Coleman (2007) that for corporate governance of any institution to be effective, it is important that its Board of Directors are independent and that all the

directors perfectly understand how value is added in the business. Lauer contended that all board directors need to undergo a regular induction and governance training program so as to keep abreast with changes that occur in business to enable them appreciate their company's place in the competitive market as well as the economic, social and political context in which the company operates. These results further concur with conclusions by Cherono (2008) that boards must be flexible enough to accommodate the need for frequent meetings, ensure a high level of participation and involvement for a streamlined and effective decision making process in line with the characteristics of micro-financing. Similarities were also noted to exist between the results obtained from this study and the study by Miring'u and Muoria (2011) analyzed the effects of corporate governance on performance of commercial state corporations in Kenya and concluded that there was a positive relationship between Return on Equity (ROE) and board compositions of all State Corporations. The standard deviation and mean achieved for all the research items are also presented in Table 4.32.

The results obtained from this study strongly reinforce the point that board sizes and composition in an organization and segregation of duties through board sub-committees enhance the performance of organizations, in this case, MFIs in their efforts to transform the MSMEs. These high rating results obtained from the study also affirm the fact that MFI boards that are independent with well designed subcommittees lead to enhanced effective monitoring and oversight and thus facilitate the transformation of MSMEs. Besides, boards that have a mix of both independent non-executives directors inject a culture of self-sensor with the aim of enhancing performance, and thus, transform the performance of MSMEs clients.

4.7.5 Inferential Statistics for Governance System and Transformation of MSMEs

4.7.5.1 Linearity Test for Governance System and Transformation of MSMEs

A test of linearity is one such crucial test as it directly relates to the bias of the results of the whole analysis (Keith, 2006). Linearity defines the dependent variable as a linear function of the predictor (independent) variables (Darlington, 1968). Multiple regressions can accurately estimate the relationship between dependent and independent variables when the relationship is linear in nature (Osborne and Waters, 2002). The study sought to establish whether governance systems and transformation of MSMEs had a linear relationship between them. A curvilinear graph was generated from SPSS data and presented in Figure 4.9 of this thesis. The figure shows that the scatter dots fall within the curvilinear line which implies that a positive linear relationship exist between governance systems and transformation of MSMEs as most of the scatter dots lie within or close to the line of best fit.

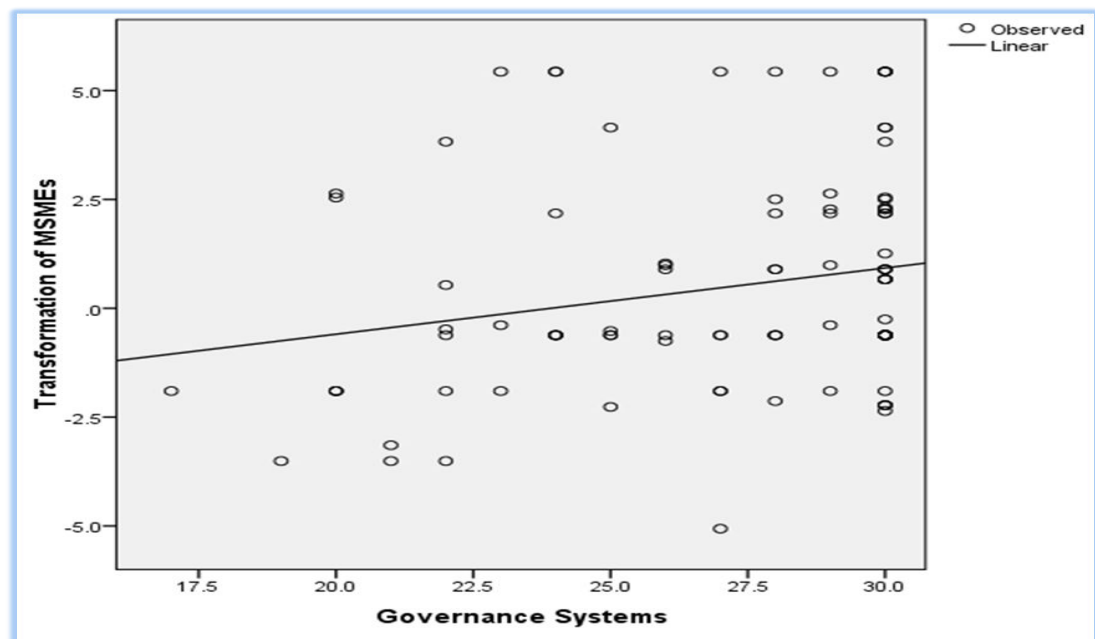


Figure 4.11: A Curvilinear Graph between Governance System and Transformation of MSMEs

4.7.5.2 Correlation between Governance System and Transformation of MSMEs

Pearson's correlation is used when you are working with two quantitative variables in a population. The possible research hypotheses are that the variables will show a positive linear relationship, a negative linear relationship, or no linear relationship at all (Keith, 2006; Stevens, 2009; Osborne & Waters, 2002). These authors argue that Pearson's correlation coefficients indicate the extent of interdependence between two variables. The Pearson correlation coefficient, r , can take a range of values from +1 to -1. A value of 0 indicates that there is no association between the two variables. Pearson's Correlation coefficients indicates the extent of interdependence between two variables. This study sought to establish whether there was correlation between governance systems and transformation of MSMEs. The findings are summarized in Table 4.33. From the table, a positive Pearson correlation coefficient of .234 or 23.4% was found to exist between governance systems and the transformation of MSMEs.

Table 4.33: Correlation between Governance Systems and Transformation of MSMEs

		Correlations	
		Transformation of MSMEs	Governance Systems
Transformation of MSMEs	of Pearson Correlation	1	.234*
	Sig. (2-tailed)		.018
	N	102	102
Governance Systems	Pearson Correlation	.234*	1
	Sig. (2-tailed)	.018	
	N	102	102

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

4.7.5.3 Regression Analysis for Governance Systems

Linear regression refers to a linear estimation of the relationship between a dependent variable and one or more independent variables. According to Jaccard *et al.*, (2006), regression analyses are usually driven by a theoretical or a conceptual model that can be drawn in the form of a path diagram. The path diagram provides the model for setting the regression and what statistics to exam. Multiple regression is widely used to estimate the size and significance of the effects of a number of independent variables on a dependent variable (Osborne & Waters, 2002). A regression analysis was carried out in order to determine whether the independent variable, governance systems could be relied on in explaining the change in the dependent variable, the transformation of MSMEs in Kenya. The model summary of the regression coefficients findings are presented in Table 4.34. The coefficients obtained indicate that the correlation coefficient (R) between the independent variable and the transformation of MSMEs in Kenya was .234 which is a positive correlation relationship. From Table 4.34, this variable achieved a coefficient of determination (R^2) of .055, which means that this variable alone can explain up to 5.5% of the total variability in the dependent variable, transformation of MSMEs in Kenya. .

Table 4.34: Model Summary of Governance System and Transformation of MSMEs

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.234	.055	.045	1.594

Predictors: (Constant), Governance Systems

4.7.5.4 ANOVA test for Governance Systems and Transformation of MSMEs

The acronym ANOVA refers to analysis of variance and is a statistical procedure used to test the degree to which two or more groups vary or differ in an experiment. ANOVA tests splits the aggregate variability found inside a data set into two parts: systematic factors and random factors (Jaccard *et al.*, (2006). In most experiments, a great deal of variance (or difference) usually indicates that there was a significant finding from the research. The systematic factors have a statistical influence on the given data set, but the random factors do not. Analysts use the analysis of the variance test to determine the result independent variables have on the dependent variable amid a regression study (Keith, 2006).

An ANOVA test was performed on the variable, governance systems and the results obtained are summarized in Table 4.35. From this Table, 4.35, the model is found to be statistically significant in explaining the variability in the dependent variable, transformation of MSMEs as its p-value is 0.018, which is less than the .05 threshold. This means, therefore, that the null hypothesis that governance system does not have a statistically significant influence on the transformation of MSMEs is rejected and instead the alternative hypothesis that it has a statistically significant influence on the transformation of MSMEs is accepted. Table 4.35 shows that the variable has a P- value equals to .018, demonstrating that the model is statistically significant in explaining the change in the dependent variable, considering that the P- value is less than .05 at the 95% level of confidence.

Table 4.35: ANOVA Table of Governance System and Transformation of MSMEs

		ANOVA				
		Sum of		Mean		
Model		Squares	df	Square	F	Sig.
1	Regression	14.716	1	14.716	5.793	.018
	Residual	254.039	100	2.540		
	Total	268.755	101			

To compliment the findings on governance system and transformation of MSMEs generated from the ANOVA test results, Person's correlation coefficients were also generated. The results of the person's correlation are presented in Table 4.36. These results show that governance systems contribute a statistically significant value (p-value = .000) of .110 to the regression model.

Table 4.36: Coefficients Table of Governance Systems and Transformation of MSMEs

Model		Unstandardized		Standardized		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	13.718	1.255		10.926	.000
	Governance Systems	.110	.046	.234	2.407	.018

Using the summary presented in Table 4.36, a linear regression model of the form, $Y = \alpha + \beta X_i$ can be fitted as follows:

$$Y = 13.718 + 0.110X_4 + e \dots\dots\dots \text{Equation 4}$$

4.8 Results and Findings on Influence of Financial Management Systems

4.8.1 Introduction

Literature reviewed in chapter two of this thesis on the influence of financial management systems on the transformation of MSMEs and found out that while MFIs reach the very poor, their reach to the disadvantaged particularly to women was limited. From the financial sustainability angle, the literature reviewed revealed that MFIs are operationally sustainable. When measured on the basis of their return on asset and return on equity, the industry's profit performance was found to have improved over time. This study sought for responses on four key investigation areas relating to financial management systems and the transformation of MSMEs. Results obtained from this investigation are discussed in sections 4.8.2 to 4.8.5 of this thesis.

4.8.2 Reliability Test on Financial Management Systems

According to Jack and Clarke (1998) reliability refers to the repeatability, stability or internal consistency of a questionnaire. According to Sekaran (2008), Cooper and Schindler (2003), Cronbach's alpha has the most utility for multi-item scales at the interval level of measurement, requires only a single administration and provides a unique, quantitative estimate of the internal consistency of a scale. A reliability test was carried out on financial management systems of MFI's to establish their influence on the transformation of MSMEs in Kenya. The results from this test are summarized in Table 4.37. These results indicate that financial management systems had a Cronbach reliability alpha score of .664 which, when rounded of to one decimal point is equal to the alpha threshold score of .7.

Table 4.37: Reliability test on Financial Management Systems

Reliability Statistics	
Cronbach Alpha	N of Items
.664	4

4.8.3 Factor Analysis on Financial Management Systems

Factor analysis is a statistical method used to describe variability among observed, correlated variables in terms of a potentially lower number of unobserved variables called factors (Kothari, 2004; Cooper & Schindler, 2003). A factor analysis was carried out on financial management systems to establish how different factors load in relation to the transformation of MSMEs. The findings presented in Table 4.38 show that all the factors loaded highly as none had a score below the threshold of .4 and therefore none was eliminated from further analysis.

Table 4.38: Factor analysis for Financial Management Systems

Component Matrix	
	Component
	1
The revenue base of our organization has greatly assisted MSMEs in expanding their businesses	.797
Our organization has good cash management skills	.785
Our organization has a good revenue base built over time	.760
The repayment period for the MSMEs loan is adequate	.474

Extraction Method: Principal Component Analysis.

4.8.4 Descriptive Statistics for Financial Management Systems

Descriptive statistics is important because it enables us to present data in a meaningful way, and therefore allows for a simpler interpretation of the data in any form of research (Cooper & Schindler, 2003; Sekaran, 2008; Kothari, 2004). An analysis of the descriptive statistics for financial management systems was carried out and a descriptive statistics table was generated from SPSS software. The results generated are presented in form of percentages as shown in Table 4.39.

Influence of financial management systems on transformation of MSMEs

The study sought to ascertain the influence of financial management systems in MFIs in transforming MSMEs. The results on all the four questions raised as illustrated in Table 4.39 indicate that the highest scores were recorded under the agreed column response with 65.7% agreeing that their organizations have a good revenue base built over time. On the question of whether the respondents' organizations had good cash management skills, 53.9% of them agreed, 61.8% agreed that the repayment period for the MSMEs loans was adequate, while 66.7% agreed that the revenue base of their organizations has greatly assisted MSMEs in expanding their businesses.

Table 4.39: Descriptive Statistics for Financial Management Systems

Research Item	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree	Mean	Std. Deviation
Our organization has a good revenue base built over time	1.0%	2.0%	4.9%	65.7%	26.5%	4.15	.681
Our organization has good cash management skills	0.0%	2.0%	10.8%	53.9%	33.3%	4.19	.700
The repayment period for the MSMEs loan is adequate	1.0%	1.0%	6.9%	61.8%	29.4%	4.18	.681
The revenue base of our organization has greatly assisted MSMEs in expanding their businesses	0.0%	1.0%	8.8%	66.7%	23.5%	4.13	.592

The results obtained from this area of investigation confirm from financial sustainability angle, MFIs are operationally sustainable measured by return on asset and return on equity and that the industry's profit performance is improving over time. The results also agree with Cull, Demirguc-Kunt and Murdoch (2007) assertion that with time, microcredit providers had increased their earnings while their costs decreased due to effective financial management systems employed. The authors also argued that in such cases, financial gain had become more important than sustainable development of their clients. Cull, Demirguc-Kunt and Murdoch (2007) saw efficient financial management systems as a factor that caused 'mission drift' which was defined as a shift in the composition of MFI clients or a re-orientation from poorer to wealthier clients among existing clients. These results further reinforce findings reported by Bett (2007) that there was a significant positive relationship between lending interest rates and performance (profitability) of SACCOs. The standard deviation and mean achieved for all the research items are also presented in Table 4.39.

These results obtained from investigations in this area show that strong financial management systems have a direct positive relationships with the performance of MFIs, which in turn lead to transformation of MSMEs. Micro-financing institutions exist in order to generate profits for their shareholders and thus it is important that sufficient profits are generated to allow for dividend payment, as well reinvestment in order to transform the future of their members' MSMEs.

4.8.5 Inferential Statistics for Financial Management and Transformation of MSMEs

4.8.5.1 Linearity Test for Financial Management Systems and Transformation of MSMEs

A test of linearity is one such crucial test as it directly relates to the bias of the results of the whole analysis (Keith, 2006). Linearity defines the dependent variable as a linear function of the predictor (independent) variables (Darlington, 1968). Multiple regressions can accurately estimate the relationship between dependent and independent variables when the relationship is linear in nature (Osborne & Waters, 2002). The study sought to establish whether financial management systems and transformation of MSMEs had a linear relationship between them. A curvilinear graph was generated from SPSS data and presented in Figure 4.11 of this thesis. The figure shows that the scatter dots fall within the curvilinear line which implies that a positive linear relationship exist between human capacity development and transformation of MSMEs as most of the scatter dots lie within or close to the line of best fit.

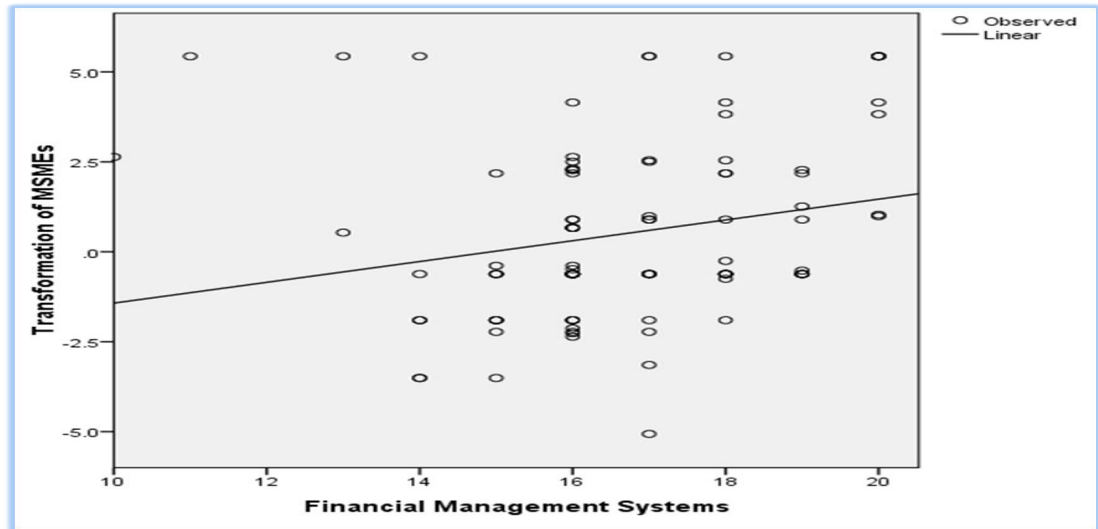


Figure 4.12: Curvilinear for Financial Management Systems and Transformation of MSMEs

4.8.5.2 Correlation between Financial Management Systems and Transformation of MSMEs

Pearson's correlation is used when you are working with two quantitative variables in a population. The possible research hypotheses are that the variables will show a positive linear relationship, a negative linear relationship, or no linear relationship at all (Keith, 2006; Stevens, 2009; Osborne & Waters, 2002). These authors argue that Pearson's correlation coefficients indicate the extent of interdependence between two variables. The Pearson correlation coefficient, r , can take a range of values from +1 to -1. A value of 0 indicates that there is no association between the two variables. Pearson's Correlation coefficients indicates the extent of interdependence between the two variables. This study sought to establish whether there was correlation between financial management systems and transformation of MSMEs. The findings are summarized in Table 4.40. From the table, a positive Pearson correlation coefficient of .222 or 22.2% was found to exist between financial management systems and the transformation of MSMEs.

Table 4.40: Correlation between Financial Management Systems and Transformation of MSMEs

		Transformation n of MSMEs	Financial Management Systems
Transformation MSMEs	of Pearson	1	.222*
	Correlation		
	Sig. (2-tailed)		.025
	N	102	102
Financial Systems	Management Pearson	.222*	1
	Correlation		
	Sig. (2-tailed)	.025	
	N	102	102

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

4.8.5.3 Regression Analysis for Financial Management Systems

Linear regression refers to a linear estimation of the relationship between a dependent variable and one or more independent variables. According to Jaccard *et al.*, (2006), regression analyses are usually driven by a theoretical or a conceptual model that can be drawn in the form of a path diagram. The path diagram provides the model for setting the regression and what statistics to exam. Multiple regression is widely used to estimate the size and significance of the effects of a number of independent variables on a dependent variable (Osborne & Waters, 2002). A regression analysis was carried out in order to determine whether the independent variable, financial management systems could be relied on in explaining the change in the dependent variable, the transformation of MSMEs in Kenya. The model summary of the regression coefficients findings are presented in Table 4.41. The coefficients obtained indicate that the correlation coefficient (R) between the independent variable and the transformation of MSMEs in Kenya was .222 which is a positive correlation relationship. From Table 4.41, this variable achieved a coefficient of determination (R^2) of .049, which means that this variable alone can

explain up to 4.9% or 5.0% of the total variability in the dependent variable, transformation of MSMEs in Kenya. .

Table 4.41: Model Summary of Financial Management Systems and Transformation of MSMEs

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.222 ^a	.049	.040	1.599

Predictors: (Constant), Financial Management Systems

4.8.5.4 ANOVA Test for Financial Management Systems

The acronym ANOVA refers to analysis of variance and is a statistical procedure used to test the degree to which two or more groups vary or differ in an experiment. ANOVA tests splits the aggregate variability found inside a data set into two parts: systematic factors and random factors (Jaccard *et al.*, 2006). In most experiments, a great deal of variance (or difference) usually indicates that there was a significant finding from the research. The systematic factors have a statistical influence on the given data set, but the random factors do not. Analysts use the analysis of the variance test to determine the result independent variables have on the dependent variable amid a regression study (Keith, 2006).

An ANOVA test was performed on the variable, financial management systems and the results obtained are summarized in Table 4.42. From this Table, 4.42, the model is found to be statistically significant in explaining the variability in the dependent variable, transformation of MSMEs as its p-value is .025, which is less than the .05 threshold. This means, therefore, that the null hypothesis that financial management systems do not have a statistically significant influence on the transformation of MSMEs is rejected and instead the alternative hypothesis that it has a statistically significant influence on the transformation of MSMEs is accepted. Table 4.42 shows that the variable has a P- value equals to .025, demonstrating that the model is statistically significant in explaining the change in the dependent variable, considering that the P-value is less than .05 at the 95% level of confidence.

Table 4.42: ANOVA for Financial Management Systems and Transformation of MSMEs

ANOVA						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	13.189	1	13.189	5.161	.025 ^b
	Residual	255.566	100	2.556		
	Total	268.755	101			

To compliment the findings on financial management systems, similar to all the other variables, and transformation of MSMEs generated from the ANOVA test results, Person's correlation coefficients were also obtained. The results of the person's correlation are presented in Table 4.43. These results show that financial management systems contribute a statistically significant value (p-value = .000) of .193 to the regression model.

Table 4.43: Coefficients of Financial Management Systems and Transformation of MSMEs

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	13.512	1.419		9.520	.000
	Financial Management Systems	.193	.085	.222	2.272	.025

Using the summary presented in Table 4.43, a linear regression model of the form, $Y = \alpha + \beta X_i$ can be fitted as follows:

$$Y = 13.512 + 0.193X_5 + e \dots\dots\dots \text{Equation 5}$$

4.9 The Influence of Combined Independent Variables on the Dependent Variable

The study sought to find out the combined influence of all the independent variables, institutional policies, management functions, human capacity development, governance systems and financial management systems on the dependent variable, transformation of MSMEs. A regression analysis was done and the results were presented in Table 4.44. Based on the model summary in Table 4.44, this study revealed that there was a .525 correlation coefficient (R) or (52.5%) between all the combined independent variables and the dependent variable, transformation of MSMEs. The results further revealed a combined coefficient of determination (R^2) of .276. This means that taken together, all the independent variables of this study, viz; institutional policies, management functions, human capacity development, governance systems and financial management systems can only explain a total variability equivalent to 27.6% in the transformation of MSMEs. This further means

that, there are other factors other than those studied that explain the total variability in the transformation of MSMEs to the tune of 72.4%.

Table 4.44: Combined Model Summary Independent variables and Transformation of MSMEs

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.525 ^a	.276	.238	1.424

a. Predictors: (Constant), Financial Management Systems, Institutional Policies, Management Functions, Governance Systems, Human Resource Management

From the ANOVA Table 4.45, the regression model is statistically significant in explaining the change in the dependent variable as p-value was found to be, .000, which is less than the .05 threshold. In addition, the null hypothesis that the combined independent variables do not have a statistically significant influence on the transformation of MSMEs is rejected and the alternative hypothesis that combined independent variables have a statistically significant influence on the transformation of MSMEs is accepted.

Table 4.45: ANOVA of all independent variables and Transformation of MSMEs

ANOVA						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	74.085	5	14.817	7.307	.000 ^b
	Residual	194.670	96	2.028		
	Total	268.755	101			

The Coefficient Table 4.46 shows that institutional policies and management functions contributes statistically significant values of .275 and .140 respectively, for every unit change in the dependent variable (Transformation of MSMEs). Human Resource Management and Governance Systems contribute negatively to the regression model while financial management systems contribute positively. However, their contributions are statistically insignificant.

Table 4.46: Coefficients of all the combined independent variables and Transformation of MSMEs

		Coefficients				
		Unstandardized Coefficients		Standardized Coefficients		
		Std. Error				
Model		B	Std. Error	Beta	t	Sig.
1	(Constant)	8.442	1.614		5.232	.000
	Institutional Policies	.275	.077	.428	3.583	.001
	Management Functions	.140	.062	.266	2.282	.025
	Human Capacity Dev.	-.049	.079	-.081	-.620	.537
	Governance Systems	-.055	.058	-.116	-.937	.351
	Financial Management Systems	.070	.094	.081	.742	.460

Dependent Variable: Transformation of MSMEs

A resultant combined linear regression model of the form, $Y = \alpha + \beta X_i$ can be fitted as follows using the data in Table 4.46;

$$Y = 8.442 + 0.273X_1 + 0.140X_2 - 0.49X_3 - 0.055X_4 + 0.070X_5 + e \dots\dots\dots \text{Equation 6}$$

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter summarises the findings of the study. It describes the influence of MFIs institutional policies, management functions, human resources development, governance and financial management systems in the transformation of Micro, Small, and Medium Enterprises (MSMEs) in Kenya. The study draws conclusions from the findings and makes recommendations on how MFIs could make more contributions through the provision of financial and non-financial services in order to ensure a complete, profound and radical change of MSMEs with the view of orienting them towards growth and financial sustainability. The chapter concludes by proposing areas for further research.

5.2 Summary of Findings

This section summarizes the findings of the study on the basis of the specific research objectives of the study.

5.2.1 Determining if MFI institutional policies play a role in transforming Micro, Small and Medium Enterprises in Kenya

The first specific objective of this study was to determine if MFI institutional policies played a role in transforming Micro, Small and Medium Enterprises in Kenya. The study established that; a majority of over 94.1% of the respondents either agreed or strongly agreed that their MFI institutions had formal and written discipline policies and procedures that enables them to effectively support their MSMEs clients; over 94.8% majority agreed that written procedures and instructions were critical in driving the quality of their support to MSMEs; over 84.4% majority strongly supported the idea that empirical data collected from time to time was very useful in assessing the performance of their clients, the MSMEs; over 89.2% supported the argument that their MFI institutions valued the information gathered about their clients for purposes of credit operation reviews; and that an overwhelming response

of over 95.1% agreed that their MFI credit operations thoroughly checked the completeness and the consistency of their MSMEs client borrowers in a bid to support their transformation.

The results also established that there existed a positive linear relationship between institutional policies and the transformation of MSMEs with a correlation coefficient of 46.3%. The results further established that institutional policies, alone, as a predictor variable could explain up to 21.5% of the total variability in the dependent variable, the transformation of MSMEs. The Analysis of variance (ANOVA) confirmed that institutional policies were statistically significant in explaining the change in the dependent variable considering that its P-Value result was less than .05 at 95% level of significance.

5.2.2 Investigating the influence of MFI management functions in transforming Micro, Small and Medium Enterprises in Kenya

The second specific objective of this study was to investigate the influence of MFI management functions in transforming Micro, Small and Medium Enterprises in Kenya. The study established that; a majority of over 86.3% of the respondents either agreed or strongly agreed that there existed strong communications within their MFI organizations and their clients, the MSMEs; over 70.6% majority both agreed and strongly agreed that written procedures and instructions were critical in driving the quality of their support to MSMEs; over 85.3% said that there were well trained and experienced employees in their MFI organizations who are capable of delivering high quality services to their clients; 93.2% of the respondents were unanimous that their organizations' operations were always based on their existing strategic plan, with a specific focus on enhanced service delivery to customers; over 68.8% of the respondents agreed that managers in their organizations took appropriate action on new and innovative ideas generated from among their employees in order to improve support to their clients; and that over 79.4% thought that their management teams were easily accessible by their clients on business related matters. The results also established that there existed a positive linear relationship between management functions and the transformation of MSMEs with a correlation coefficient of 39.5%.

The results further established that management functions, alone, as a predictor variable could explain up to 15.6% of the total variability in the dependent variable, the transformation of MSMEs. The Analysis of variance (ANOVA) confirmed that management functions were statistically significant in explaining the change in the dependent variable considering that its P-Value result was less than .05 at 95% level of significance.

5.2.3 Establishing how MFI human resource management contributes to transforming Micro, Small and Medium Enterprises in Kenya

The third specific objective of the study was to establish how MFI human resource management contributes to transforming Micro, Small and Medium Enterprises in Kenya. The study established that; a majority of over 63.7% of the respondents either agreed or strongly agreed that their MFI institutions used problem solving aptitude tests and customer service as key criteria in employee selection. There was a 35.3% neutral response on this statement, which could explain the variability in approach among the various institutions on the issue of recruitment and employee selection.

The study also revealed that 51% of the respondents either agreed or strongly agreed that incentive system in their organizations rewarded staff in order to accomplish work objectives with high satisfaction to clients. Here again, the results recorded another high neutral response of over 41.2%, meaning that this approach was not generally applied in all the MFIs involved in the study. A majority of 79.4% were unanimous that their organizations selected employees who could provide ideas to improve the operation processes of their organizations and that this adequately supported the MSME clients; over 86.3% of the respondents were unanimous that their organizations selected employees who were able to work well in teams and effectively support their MSME clients.

The results also revealed that a majority of over 79.4% of the respondents either agreed or strongly agreed that training provided by their institutions had transformative effects on the MSMEs that they supported. The results also established that there existed a positive linear relationship between human capacity development and the transformation of MSMEs with a correlation coefficient of

22.7%. The results further established that human capacity development, alone, as a predictor variable could only explain up to 5.2% of the total variability in the dependent variable, the transformation of MSMEs. The Analysis of variance (ANOVA) confirmed that human capacity development were statistically significant in explaining the change in the dependent variable considering that its P-Value result was less than .05 at 95% level of significance.

5.2.4 Examining if governance of MFIs has influence in transforming Micro, Small and Medium Enterprises in Kenya

The fourth specific objective of the study was to examine if governance of MFIs had influence in transforming Micro, Small and Medium Enterprises in Kenya. The study established that; a majority of over 96.1% of the respondents either agreed or strongly agreed that the constitution of effective boards and independent sub-committees were critically important in the effective monitoring and oversight roles for enhancing the transformation of MSMEs; a majority of 88.2% of the respondents agreed their MFI organizations recognized the roles of non-executive members and their oversight responsibilities in the effective management of the MFIs; 89.2% of the respondents unanimously confirmed that board sub-committees in their organizations had led to better MFI performance which in turn led to the transformation of their MSMEs; 75.4% of the respondents were in agreement that there was proper coordination and communication among the board of directors and with their MSME clients; 89.2% of the respondents were positive that their boards had diverse skills that and knowledge that was relevant to MFI management; and 89.2% of the respondents thought that board decisions had impacted positively on the transformation of their MSME clients.

The results also established that there existed a positive linear relationship between governance systems and the transformation of MSMEs with a correlation coefficient of 23.7%. The results further established that governance systems, alone, as a predictor variable could explain up to 5.5% of the total variability in the dependent variable, the transformation of MSMEs. The Analysis of variance (ANOVA) confirmed that governance systems were statistically significant in explaining the

change in the dependent variable considering that its P-Value result was less than .05 at 95% level of significance.

5.2.5 Ascertaining the influence of MFI's financial management systems in transforming Micro, Small and Medium Enterprises in Kenya

The fifth and last specific objective of the study was to ascertain the influence of MFI's financial management systems in transforming Micro, Small and Medium Enterprises in Kenya. The study established that; a majority of over 92.2% of the respondents either agreed or strongly agreed that their MFI institutions were financially stable with good revenue streams built over time; over 87.2% of the respondents were unanimous that MFIs had good cash flow management skills which had helped them effectively support the transformation of their MSMEs clients; over 91.2% of the respondents thought that the credit repayment periods of their organizations for the loans borrowed by MSME clients were adequate and supportive to their transformation; and 90.2% of the respondents thought that their MFI revenue base had greatly assisted their MSME clients in expanding their businesses.

The results also established that there existed a positive linear relationship between financial management systems and the transformation of MSMEs with a correlation coefficient of 22.2%. The results further established that financial management systems, alone, as a predictor variable could only explain up to 4.9% of the total variability in the dependent variable, the transformation of MSMEs. The Analysis of variance (ANOVA) confirmed that financial management systems were statistically significant in explaining the change in the dependent variable considering that its P-Value result was less than .05 at 95% level of significance.

5.3 Conclusions

Based on the findings presented in chapter four and the summaries contained in section 5.2 of this thesis, the study concludes that;

5.3.1 Determining if MFI institutional policies play a role in transforming Micro, Small and Medium Enterprises in Kenya

In determining if institutional policies play a role in transforming Micro, Small and Medium Enterprises in Kenya, the study concluded that MFIs have a significant transformative influence of MSMEs through the establishment of internal institutional policies aimed at improving their business climate. The critical priority of the MFIs is to develop a conducive regulatory and business environment that removes impediments to accessing and providing financing to MSMEs.

The results of this study turned a resounding message that having formal and written regulatory policies that instil discipline in the operating environment and internal operations of MFIs enables the MFIs to effectively support the transformation of MSMEs clients. It can also be concluded, based on the results that having written policies, procedures and instructions are critical in driving the quality of support provided by MFIs to their MSME clients. It can also be concluded that one way of addressing the changing customer needs from time to time is to ensure that policy and regularity instruments applied on MSMEs clients are developed on the basis of timely research on customer tastes. So, reliance on empirical data collected regularly is very useful in assessing the performance of their clients and at the same time making effective changes that support the transformation of MSMEs.

It is also an important practice that MFIs thoroughly checks the completeness, accuracy and consistency of information gathered from their MSMEs clients interested in borrowing funds in order to ensure that credit decisions are based on accurate information if transforming these MSMEs is to be successful. Based on the findings of this study, it can also be concluded that institutional policies, indeed, have a statistically significant effect in the transformation of MSMEs and therefore there should be more focus in their continuous development and application.

5.3.2 Investigating the influence of MFI management functions in transforming Micro, Small and Medium Enterprises in Kenya

Upon investigating the influence of MFI management functions in transforming Micro, Small and Medium Enterprises in Kenya, the study concluded that putting up

proper managerial structures and processes in MFI operations are critical in influencing the transformation of the MSMEs. Effective management structures and processes permit institutions to attenuate and amplify talent and that this is critical for organizational stability and support to their stakeholders, such as the MSMEs.

As revealed by the results of this study, establishing strong communications systems within MFIs and with client MSMEs is critical for the transformation of the MSMEs. These communication systems and other management structures are even more critical in the efficient operations of the MFIs if the same can be in written form and regularly reviewed so that there is uniformity in their application to the MSMEs. Written management systems, including the delineation of responsibilities and powers serve as a succession tool which ensures continuity and consistency in supporting the MSMEs. Further, written management systems, procedures and instructions are also critical in driving the quality of support to MSMEs by virtue of consistency in application.

It should also be noted that an institution with well trained staff that are capable of correctly interpreting the management responsibilities and respecting their lines of authority enhance the transformative support given to MSMEs. Well trained and experienced employees and their managers have the ability to deliver high quality services to clients. Equally important in transforming and enhancing the quality of support given to the MSMEs is constant scanning and supporting innovative ideas and contributions that emanate from employees of the MFIs aimed at improving the quality of service delivery to the MSMEs. The practicing of open door policy by managers to ensure access by all in the institutions for timely and effective decision making is also very important. It can also be concluded, based on the results of this study that management functions have a statistically significant effect in the transformation of MSMEs and, therefore, there should be adequate focus in creating such structures for greater impact to and growth of the MSMEs.

5.3.3 Establishing how MFI human resource management contributes to transforming Micro, Small and Medium Enterprises in Kenya

With regards to establishing how MFI human resource management contributes to transforming Micro, Small and Medium Enterprises in Kenya, the study concluded that human capacity development is linked to the enhanced growth of leading institutions both locally and internationally. As noted in the literature review, Google Company was in 2010 quoted by Fortune 500 as one that practices very good human resources development systems and this has made the company one of the greatest and coveted in the contemporary world.

In general, human resources in any institution is the most important asset because it is indeed people working in an institution that contribute towards the achievement of the enterprise's goals and aspirations. It is also people that take care of the rest of the organizational resources and ensure their effective functioning and efficient utilization. It can also be confidently said that the security, safety and maintenance of the other resources such as money, machineries, minutes (time), methods and materials are at the mercy of the manpower of the Organization. Therefore developing good problem solving procedures as well as aptitude tests aligned to the responsibilities during recruitment is critical to the success of the organization and the stakeholders.

Further, developing of strong incentive and reward systems by institutions is a pre-condition for enhanced quality of support services to MSMEs. It can also be concluded that this study strongly values a careful selection process of employees that uphold high team values and capable of providing practical ideas aimed at improving operational processes of their organizations in a bid to enhance the quality and adequacy of support to MSME clients. To ensure continued high quality support to the MSMEs, the study concludes that training is a major and pertinent component of sound human capacity development systems. Even though the results revealed that human capacity development could only explain up to 5.2% of the total variability in the dependent variable, the transformation of MSMEs, this predictor variable, is nevertheless statistically significant in explaining that change.

5.3.4 Examining if governance of MFIs has influence in transforming Micro, Small and Medium Enterprises in Kenya

On examining if governance of MFIs has influence in transforming Micro, Small and Medium Enterprises in Kenya, and relating the same to the literature reviewed, the study concluded that corporate governance in a number of MFI is generally considered weak. For corporate governance to be effective, it is important to confirm that independent and non-executive directors are put in place and are independent. They should also understand the business of the institution. All directors are meant to understand how their contribution adds value to the well being of the organization. Appointment of board members is an exercise that needs to be approached with sobriety to ensure that each board member brings certain key skills that will bear on the successful management of the organization.

Investigations from this study lead us to conclude that the constitution of effective boards and independent sub-committees are critically important in the monitoring and oversight functions of MFIs for transformative support to MSMEs. It can also be concluded that segregation of duties through board sub-committees leads to tangible positive results and performance of MFIs which in turn leads to the transformation of MSMEs. Existence of effective communication between the overall board, the sub-committee and management is healthy for the performance of MFIs and by extension, the support provided to the MSMEs.

Board diversity is a critical and important aspect of any well performing institution; diversity in this case refers to membership that possesses different and relevant skills sets that compliment the strong managerial function in any institution. It can also be concluded that in spite of its low coefficient of determination value (R^2), governance systems, nevertheless have a statistically significant effect on the variability of the dependent variable.

5.3.5 Ascertaining the influence of MFI's financial management systems in transforming Micro, Small and Medium Enterprises in Kenya

With regards to ascertaining the influence of MFI's financial management systems in transforming Micro, Small and Medium Enterprises in Kenya, this study concluded

that MFIs should be financially stable with good revenue streams built over time for them to be of strong and transformative support to the MSMEs. In particular, such MFIs must have strong liquidity, meaning strong cash flows that help enhance the borrowing needs of the MSMEs that they support. To be able to enjoy good revenue streams and cash flow status, the MFIs should possess good cash flow and financial management skills as revealed by this study in order for them to effectively support the transformation of their MSME clients.

The findings from this study show that management should ensure that reasonable credit periods in terms of loans offered to MSME clients need to be adequate and supportive to their transformation. Another conclusion that can be made from this study is that sound MFI revenue base greatly assists MSME clients in expanding their businesses by accessing financing from the MFIs. Even though financial management systems determine only a 4.9% variability in the transformation of the MSMEs, based on the results of this study, it is worth noting that financial management systems are statistically significant in explaining the transformative change considering that its p-value result was less than .05 at 95% level of significance.

5.4 Recommendations

Based on the findings and outcome of this study and for the MFIs to continue influencing the transformation of MSMEs in Kenya, the study recommends that;

5.4.1 Determining if MFI institutional policies play a role in transforming Micro, Small and Medium Enterprises in Kenya

With regards to the specific objective on the role of institutional policies in transforming Micro, Small and Medium Enterprises in Kenya, the researcher recommends that MFIs should develop and document effective internal institutional policies aimed at improving their business climate. In particular, the MFIs should; develop a conducive regulatory and business environment that removes impediments to accessing and providing financing to MSMEs; MFIs should have formal and written regulatory policies that instil discipline in the operating environment to enable MFIs to effectively support the transformation of MSMEs clients.

In order to effectively respond to the changing customer needs from time to time, policy and regularity instruments applied on MSMEs clients should be developed on the basis of timely research on customer tastes; and that MFIs should regularly and thoroughly check the completeness and the consistency of information gathered from their MSMEs clients interested in borrowing funds. This will ensure that credit decisions are based on accurate information to facilitate the transformation of MSMEs and make them a big success;

5.4.2 Investigating the influence of MFI management functions in transforming Micro, Small and Medium Enterprises in Kenya

With regards to the specific objective on the influence of MFI management functions in transforming Micro, Small and Medium Enterprises in Kenya, the researcher recommends that in order for the MFIs to influence transformative changes and ensure stability in the MSMEs, development of sound and effective management structures and processes is imperative. There is need to establish strong communications systems within the MFIs and their client MSMEs for the transformation of the MSMEs. The communication systems and other management structures to be established should be in written form and be regularly reviewed so that there is uniformity in their application to the MSMEs.

MFIs should ensure they recruit well trained personnel capable of correctly interpreting the management responsibilities and respecting their lines of authority in order to enhance the transformative support given to MSMEs. They should ensure regular scanning and supporting innovative ideas and contributions that emanate from employees of the MFIs aimed at improving the quality of service delivery to the MSMEs. Management should develop open door policy by managers ensuring access by all in the institutions for timely and effective decision making.

5.4.3 Establishing how MFI human resource management contributes to transforming Micro, Small and Medium Enterprises in Kenya

On the specific objective to establish how MFI human resource management contributes to transforming Micro, Small and Medium Enterprises in Kenya, the researcher recommends that the development of good problem solving procedures as

well as aptitude tests aligned to the responsibilities during recruitment as a critical tool for the success of the organization and the stakeholders; development of strong incentive and reward systems by MFIs as a pre-condition for enhanced quality of support services to MSMEs; development of careful selection process of employees that uphold high team values and capable of providing practical ideas aimed at improving operational processes of MFIs in a bid to enhance the quality and adequacy of support to MSME clients; ensure that formal trainings is a major and pertinent component of sound human capacity development systems .

5.4.4 Examining if governance of MFIs has influence in transforming Micro, Small and Medium Enterprises in Kenya

With regards to the specific objective of examining if governance of MFIs has influence in transforming Micro, Small and Medium Enterprises in Kenya, the researcher recommends that for corporate governance to be effective, it is important to confirm that independent, non-executive directors are not so independent that they do not understand the business of the institution; ensure that all directors understand how their contribution to the MFI adds value to the well being of the organization; appointment of board members is approached with sobriety to ensure that each board member brings certain key skills that will bear on the successful management of the organization.

Further, the constitution of effective boards and independent sub-committees should be carefully made as these are critically important in the monitoring and oversight functions of MFIs for transformative support to MSMEs; ensure effective segregation of duties through board sub-committees in order to leads to tangible positive results and performance of MFIs which in turn leads to the transformation of MSMEs; ensure existence of effective communication between the overall board, the sub-commitment and management as a healthy tool for the performance of MFIs and by extension, the support provided to the MSMEs; and, emphasis is laid on board diversity as a critical and important aspect of a well performing Micro Finance Institution.

5.4.5 Ascertaining the influence of MFI's financial management systems in transforming Micro, Small and Medium Enterprises in Kenya

On the specific research objective of ascertaining the influence of MFI's financial management systems in transforming Micro, Small and Medium Enterprises in Kenya, the study recommends that: MFIs should develop strong and stable revenue streams for them to be of strong and transformative support to the MSMEs; MFIs must have strong liquidity, meaning strong cash flows that help enhance the borrowing needs of the MSMEs that they support; MFIs should possess good cash flow and financial management skills as revealed by this study in order for them to effectively support the transformation of their MSME clients; ensure adequate and supportive credit periods in terms of loans offered to MSME clients to enhance their transformation; and ensure sound MFI revenue base in order to assist MSME clients in expanding their businesses.

5.5 Scope for Further Research

Based on the findings of this study presented in chapters four and summarized in chapter five, the researcher recommends that a similar study be conducted in future to validate the findings of this study. One of the major findings of this study was that all the five independent variables taken together could explain up to 27.6% of the variation in the dependent variable, the transformation of MSMEs in Kenya. This means that 72.4% of the change in the transformation of MSMEs in Kenya could be explained by other variables. The researcher, therefore, proposes that a study be conducted to investigate the other factors including, MFI Financial, revenue streams, leadership styles, and diversity and entrepreneurial abilities of the MSME clients and MFI strategies towards MSMEs development, among other potential variables.

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APPENDICES

Appendix 1: Introduction Letter

Date:

Dear Respondent,

RESEARCH QUESTIONNAIRE

I am a PhD student at Jomo Kenyatta of Agriculture and Technology (JKUAT) University conducting a research entitled “**Influence of Micro Finance Institutions in transforming Micro, Small and Medium Enterprises in Kenya**”. A questionnaire has been designed and will be used to gather relevant information to address the research objectives of the study. The purpose of writing to you is to kindly request you to grant me permission to collect information on this important subject from randomly selected members of staff.

Please note that the study is an academic research and the information provided will be treated in strict confidence. Strict ethical principles will be observed to ensure confidentiality and the study outcomes and reports will not include reference to any individuals.

Your assistance is highly appreciated.

Regards,

Benson Momanyi Mwaniki

Appendix II: Questionnaire

This questionnaire is divided into five sections that should take a few minutes of your time to complete. Please respond by ticking the appropriate box in the blank spaces provided. Information collected will be treated with strict confidentiality.

SECTION 1: BASIC INFORMATION

1. Indicate your gender

Female

Male

2. Kindly indicate the Department you are working in

Administration

Accounts and finance

Risk and Compliance

Human Resources

Operations and IT

3. Position in your department

Top management

Middle Management

Supervisory

4. Level of education

College

University

Post graduate

5. How long have you been employed by the company

less than 1 year

2 to 5 years

6 to 10 years

Over 10 years

SECTION 2: Influence of Micro-Finance Institutions in Transforming Micro, Small and Medium Enterprises in Kenya

Section A: Transformation of Micro, Small and Medium Enterprises

This section is concerned with assessing the transformation of Micro, Small and Medium Enterprises in Kenya. Please mark (x) in the box which best describes your agreement or disagreement on each of the following statements; **Strongly Disagree = 1; Disagree = 2; Neutral = 3; Agree = 4 and Strongly Agree = 5.**

No.	Statement	1	2	3	4	5
1	Our MFI institution has experienced an increased number of transformed MSMEs in the last five (5) years					
2	Our improved assets base over the last 5 years has enhanced transformation of MSMEs that we support					
3	Our positive Return on Investment (ROI) over the last 5 years has transformed the MSMEs we support					
4	The products and services that we offer have contributed to the transformation of MSMEs owned by our clients					

Section B: Institutional Policies

This subsection is concerned with an investigation to find out the effect of policies in transforming micro, small and medium enterprises in Kenya. Please mark (x) in the box which best describes your agreement or disagreement; **Strongly Disagree = 1; Disagree = 2; Neutral = 3; Agree= 4 and Strongly Agree = 5.**

No.	Statement	1	2	3	4	5
1	Our Institution has a formal and written discipline policy to effectively support our MSMEs clients					
2	In this institution, written procedures and instructions are given a special importance with special focus on our MSMEs clients					
3	Our Institution collects comprehensive and current data on the economic and personal situation of the MSMEs					
4	Our Institution requires that all the information gathered about our clients is passed on to the credit operations for review					
5	The credit operations unit does preliminary review of the completeness and consistency of the borrowers' data (MSMEs)					

Section C: Management Functions

This subsection is concerned with investigation of the influence of management functions in transforming micro, small and medium enterprises in Kenya. Please mark (x) in the box which best describes your agreement or disagreement; Where **Strongly Disagree = 1; Disagree = 2; Neutral = 3; Agree= 4 and Strongly Agree = 5.**

No	Statement	1	2	3	4	5
1	There is clear division of duties and responsibility among employees with a clear focus on enhanced service delivery to					

No	Statement	1	2	3	4	5
	our clients					
2	There is effective communication within our organization and with our clients (the MSMEs)					
3	There are well trained and experienced employees in the organization who deliver high quality service to our customers (the MSMEs)					
4	Our organization's operations are always based on the developed strategic plan, with a specific focus on enhanced service to our customers					
5	Managers in our organization take action on new and innovative ideas provided by employees to improve support to our clients					
6	Our management team is easily accessible by our clients (MSMEs) on business related issues					

Section D: Human Resource Management

This subsection is concerned with establishing the effect of human resource management on transforming micro, small and medium enterprises in Kenya. Please mark (x) in the box which best describes your agreement or disagreement, **where Strongly Disagree = 1; Disagree = 2; Neutral = 3; Agree= 4 and Strongly Agree = 5.**

No	Statement	1	2	3	4	5
1	Our organization uses problem – solving aptitude and customer service as key criteria in employee selection					
2	Incentive system in our organization rewards staff that accomplish work objectives with high satisfaction to clients					
3	Our organization selects employees who can provide ideas to improve the operation process and adequately support our MSMEs clients					
4	Our organization selects employees who are able to work well in work teams and effectively support our MSMEs clients					
5	Training currently provided in our institution has transformative effects on the transformation of MSMEs that we serve					

Section E: Governance Systems

This subsection is concerned with establishing the effect of governance system of MFIs in transforming micro, small and medium enterprises in Kenya. Please mark (x) in the box which best describes your agreement or disagreement, **where Strongly Disagree = 1; Disagree = 2; Neutral = 3; Agree= 4 and strongly Agree = 5.**

No	Statement	1	2	3	4	5
1	Our Institution has an overall board and independent board subcommittees in place to enhance effective monitoring and oversight capable of enhancing the transformation of MSMEs					
2	Our Institution has board committees which consist of independent non-executives directors					
3	Board sub-committees have led to better organizational performance that by extension has led to the transformation of our MSMEs clients					
4	There is proper coordination and communication among the Board of Directors and with our clients					
5	The Board is composed of directors with varied and relevant knowledge and skills to the micro-financing industry and MSMEs sector					
6	The board decisions have impacted positively on the transformation of MSMEs					

Section F: Financial Management Systems

This subsection seeks to establish the effect of financial management systems of MFIs in transforming micro, small and medium enterprises in Kenya. Please mark (x) in the box which best describes your agreement or disagreement **where strongly disagree = 1; Disagree = 2; Neutral = 3; Agree= 4 and Strongly Agree = 5.**

No	Statement	1	2	3	4	5
1	Our organization has a good revenue base built over time					
2	Our organization has good cash management skills					
3	The repayment period for the MSMEs loan is adequate					
4	The revenue base of our organization has greatly assisted MSMEs in expanding their businesses					

Appendix III: AMFI Members

No.	MEMBER NAME	CEO/CONTACT	ADDRESS
BANKS			
1	K-rep Bank Ltd	Mr. Albert Ruturi-CEO Contact person: Microfinance Manager – Anthony Kamau (Kawangware branch)	K-Rep Centre, Wood Avenue P.O BOX 25363-00603 NAIROBI Tel 3871511 Fax 3873178 Cell : 0715 004366 registry@k-repbank.com / aruturi@k-repbank.com ; akamau@k-repbank.com
2	Equity Bank	James Mwangi-CEO	Equity Centre, Upperhill P.O BOX 75104-00200 NAIROBI Tel: 27366620/17 james.mwangi@equitybank.co.ke
3	Co-operative Bank	James Nduati-Head Micro Enterprises	Co-operative Bank of Kenya Ltd Co-operative Hse Building- 4 th Floor P.O BOX 48231-00100, NAIROBI TEL: 3276210 Fax: 249480 JNduati@co-opbank.co.ke
4	Kenya Post Office Savings Bank	Anne Karanja – Acting CEO Tel: 224949 Contact person: Vincent Makori	Market Lane Off 17 Banda Street, Postbank House P.O BOX 30311-00100 NAIROBI. Tel 229551-6 Fax: 229186 md@postbank.co.ke MakoriVO@postbank.co.ke
5	Jamii Bora Bank	Sam Kimani – CEO Pauline Kariuki – PA James Kihara- Manager Group Business	Head Office, Jamii Bora House, 18, Koinange Street P.O. Box 22741-00400 Nairobi, Kenya. Tel : 020 2224238-9 / 2210339 Mobile : 0722383813/0722201112/0734600682 Email : sam.kimani@jamiiborabank.co.ke pauline.kariuki@jamiiborabank.co.ke james.kihara@jamiiborabank.co.ke

WHOLESALE MFIs			
6	MESPT	Priscilla Gathiga – Acting CEO John Masha - General Manager, Credit	Micro Enterprises Support Programme Trust (MESPT) MESPT Plaza, 01 Tausi Road, Westlands Between Westlands Road and Muthithi Road P.O. Box 187, Sarit Centre, 00606, Nairobi Office cell phones: 0722-207905, 0728 817315 and 0735-333154 Email: pgathiga@mespt.org jmasha@mespt.org
7	Stromme Microfinance East Africa Ltd	Harriet Mulyanti - CEO	Stromme Microfinance East Africa Ltd Plot 25, Block LRV 235, Folio 3 Bukoto Street P.O. Box 27200 Kampala, Uganda Tel: 0414-532842 Fax: 0414-532992 E-Mail: harriet.Mulyanti@stromme.org
MICROFINANCE BANKS			
8	Kenya Women Microfinance Bank Ltd	Mwangi Githaiga - MD Contact person: Isabella Nyambura	Akira House, Kiambere Road, Upper Hill, P.O BOX 4179-00506 NAIROBI. Tel : 0703-067 000/0729-920 920/0736 633 332 mgithaiga@kwftdm.com ; Inyambura@kwftdm.com
9	Rafiki Microfinance Bank Ltd	Ken Obimbo- CEO Atif – Deputy MD George Mbira – General Manager Daniel Mavindu- Group Director	Rafiki House, along Biashara Street P.O. Box 12755-00400 Nairobi. Tel: 020 2166401 Cell: 0736 432025/0722 206917/ 0730 170 002/0722 718867 gmbira@rafiki.co.ke ; dmavindu@rafiki.co.ke ;
10	Faulu Kenya Microfinance Bank Ltd	Charles K. Njuguna Purity	Ngong Road, Ngong lane P.O BOX 60240-00200 NAIROBI Tel: 020 2518071 ; 3877290-3/7

		Raaria- Contact person	Fax:3867504/3874857 Cell: 0772-190 523; 0721-200 849; 0722 880673 charles.njuguna@faulukenya.com Purity.Raaria@faulukenya.com
11	SMEP Microfinance Bank Ltd	Simon Kamore - CEO	Kirichwa Road, Kilimani P.O BOX 64063 NAIROBI Tel:3870162/3861927 Fax:3870191 info@smep.co.ke ceo@smep.co.ke
12	Remu Microfinance Bank Ltd	Peter Mugendi- CEO	Finance House, 14th Floor, Loita street P.O. Box 20833-00100 Nairobi Tel : 020-2214483/2215387/8/9 Cell : 0716 605453 peter.mugendi@remultd.co.ke
13	Century Microfinance Bank Ltd	Eric Ndzai - CEO	New Pumwani Road K K Plaza, Gikomba Cell : 077-230570-Head Office OR 0722-168721 ; 0733-155652 Tel : 3741450 Email : info@century.co.ke endzai@century.co.ke
14	Sumac Microfinance Bank Ltd	Duncan Mwaniki CEO	Consolidated Bank Building, Koinange Street, 2 nd Floor P.O. Box 11687-00100 Nairobi Tel: 020 2210440/2212587 Fax: 020 2210430 Cell Phone: 0725 223 499 E-mail: dmwaniki@sumacmicrofinancebank.co.ke
15	UandI Microfinance Bank Ltd	S.M. Ngigi - CEO	1st Floor, Asili Complex River Road/Latema Road Junction Opposite Kampala Coach Tel: 020 2367388 Cell: 0713 -112791 E-mail: info@uni-microfinance.co.ke sngigi@uni-microfinance.co.ke

16	Caritas Microfinance Bank Ltd	George Maina – CEO, Teresia Kamala, Contact Person	Cardinal Otunga Plaza, Kaunda Street, P.O Box 15352-00100, Nairobi; Tel: 0205151500, Email: George.maina@caritas-mfb.co.ke Teresia.kamala@caritas-mfb.co.ke
RETAIL MFIs			
17	Eclof Kenya	Mary Munyiri - CEO	Royal Offices 2 nd floor, Mogotio Road off Chiromo lane, Parklands. P.O BOX 34889- 00100 NAIROBI Tel: 254-020-3742817 Wireless : 020 2471270 Cell: 0722 793330 Email: info@eclof-kenya.org admin@eclof-kenya.org mmunyiri@eclof-kenya.org
18	Vision Fund Kenya Limited	Phillip Ochola CEO Contact person: Charity Mati	Karen Road, Off Ngong Road P.O BOX 1676-00200 NAIROBI Mobile: 0722-200402; 0723-786990; 0724-856956; 0736-600997 info@visionfundkenya.co.ke ; Philip_ochola@wvi.org ; charity.mati@kadet.co.ke
19	BIMAS	Patrick Gathundu- CEO	Bimas Complex P.O BOX 2299 EMBU Tel: 068-31645 Fax: 068-31573 pgathundu@bimaskenya.com
20	SISDO	Stephen Njiri - CEO Contact persons: Charles Obonyo	Ngong Road, Ngong lane P.O BOX 76622-00508 NAIROBI Tel : 3870280/ 020 3864901 Fax: 3871531 Snjiri@sisdo.org ; cobonyo@sisdo.org
21	Micro Africa Ltd (Letshego)	Charles Njoroge - CEO	PO Box 52926 - 00200 Tel +254 20 3861 681-4 Cell +254 720 522 565 Email: info@microafricagroup.com cnjoroge@microafricagroup.com
22	Opportunity Kenya	Lydia Njoroge- CEO Contact person: Alexander	Geomaps Centre-Matumbata rd Upper Hill P.O BOX 19497-00202 Nairobi Tel: 2720159/69 Fax: 2720173 0722205171/0733606996

		Mbaye	Injoroge@opportunitykenya.com
23	YEHU Microfinance Trust	Adet N. Kachi-CEO Contact person: Joy Karanja (PA/HRO)	Buxton, Tom Mboya Street P.O BOX 82120 NAIROBI Tel: 041-224406 adetkachi@yahoo.com yehumfi@gmail.com joykar2011@gmail.com
24	Jitegemea Credit Scheme	Francis Kihiko - CEO	Jogoo Road, KCB building P.O BOX 46514, NAIROBI Tel: 535866/552169 fkihiko@jitegemea.co.ke
25	AAR Credit Services	John Kariuki – MD George Ndonga – Contact person	Methodist Ministries Centre, 1 st Floor Oloitokitok Road P.O BOX 41766 GPO Tel: 0722425040; 0736425040 Email: jkkariuki@aar.co.ke
26	Juhudi Kilimo Co.Ltd	Bernard Kivuva-CEO	The Priory Place, 2 nd Floor Argwings Kodhek Road P.O. Box 25441-00100 Nairobi Tel : 020 2642288/0715 446614/ 0733 446614 E-mail : bkivava@juhudikilimo.com
27	Musoni Kenya Ltd	James Onyutta, Chief Executive Officer Contact person – Anne Mwasi	Cape Office Park Along Ring Road Kilimani, Opposite Yaya Centre P.O. Box 25351-00100 Nairobi. Office: +254 (0) 202609355 Mobile :+ 254 (0) 716505179 E-mail: annemwasi@musoni.eu jamesonyutta@musoni.eu
28	Select Management Services Ltd	Jaco Coetzee– General Manger Contact Person:	Kenya Re towers, off Ragati Road P.O. Box 27639,00506 Nairobi. Tel: 2777500/1 Fax: 2731162 ithaer@selectafrica.net ;

		Regina Ithae - Admin and Operations Manager	coetzeej@selectafrica.net
29	Greenland Fedha Ltd	Anne Gathuku-MFI manager	KTDA farmers building P.O. Box 30213-00100 Nairobi. Tel: 32277000-2/221441-4 DL: 020 3227228 Fax:211240 Cell: 0724 577818 agathuku@ktdateas.com agathuku@yahoo.com
30	Platinum Credit Limited	Ignatius Obara Finance Director	2 nd floor, union towers, Moi avenue P.O. Box 73304-00200 Nairobi Tel: 2247950/2210109/2210105 Mobile: 0722200480/0733836845 info@platinumcredit.co.ke obara@platinumcredit.co.ke
31	Focus Capital Limited	George Ngugi Karungo - Director	Donholm Mina Centre P.O. Box 2406-00202 Nairobi. aligeproperty@rocketmail.com Tel: 0705-693555
32	Jubilant Kenya Ltd	Cyprian Kilonzo-MD	Burhaniya Bohra Edu Society Building Suit 4 P.O Box 81837-80100 Mombasa Cell phone: 0723 800549 Email: cyprian.kilonzo@jubilantkenya.com
33	Habitat for Humanity Kenya	Jonathan Waita – Programme Manager Lynette Injette - Country Director	Habitat for Humanity Kenya P.O. Box 38948 - 00623 Lenana Rd, 197 Lenana place, Hurlingham, Nairobi-Kenya Tel: 020 2572812 Cell: +254 733457461/+254 723242822/020 2572812 Email: jwaita@hfhkenya.or.ke LInjette@hfhkenya.or.ke
34	Real People	Daniel Ohonde – Chief Executive Officer	7 th Floor, International House, Mama Ngina Street P.O. Box 27153-00100 Nairobi Tel: 020 2218111 Cell: 0730 168000/ 0711 795925 dohonde@realpeople.co.ke

35	Speed Capital Ltd	James Ouma – Chief Operating Officer	Kimathi House, 8 th Floor P.O. Box 100463-00101, Nairobi Tel: 0721 441401 James.ouma@speedcapital.co.ke
36	Neema Health Educational and Empowerment Programme (NEEMA – HEEP Ltd)	Dr. Pattedy Nyagah - CEO	Neema Plaza, 2 nd Floor , Mama Ngina Street P.O. Box 1744-60100, Embu – Kenya Tel: 0716 070411 info@neemaheep.org drpnyagah@neemaheep.org
37	Micro Mobile Ltd	Robert Masinde - CEO	Regus Delta Corner Tower, 6 th Floor, Chiromo Road, Westlands P.O. Box 14805-00800 Nairobi. Tel: 0730 112013/ 0722 706253 robert.masinde@micromobile.co.ke
38	Ushindi Bora Ltd	Dominic Klins Buttuk	Bruce House, 10 th Floor Northern Wing P.O. Box 40547-00100 Nairobi Tel: 0717 111122 ushindibora@gmail.com
39	Sevenstar Capital Services LTD	Jacqueline Ndungu – Credit Manager	Uthiru Cooperation, Opposite Shell Petrol Station, P.O Box 40547 – 00100 Nairobi Tel: 0717111122, Ushindibora@gmail.com
40	Hand in Hand Eastern Africa	Pauline Ngari - CEO	Lower Hill Duplex – UpperHill P.O Box 8562-00100 Nairobi. Tel: 0703 960766 info@handinhandea.org ngari.pauline@handinhandea.org
41	Star Credit Ltd	Samuel Okelo DEya - MD	Mini Mall, 1 st Floor, Suite 314 P.O Box 3516 code 40100 Apindi Street, Kisumu Tel: +254 725018879 Sdeya@starcreditltd.com ; info@starcreditltd.com
42	Getbucks Ltd	Anthony George Maulgue	Shelter Afrique Centre Upper Hill P.o Box 5483-00100, Nairobi Tel: 0202434019/17 tony@getbucksgroup.com

43	Private Equity Ltd	Philip Muturi Mwangi	Rattansi Educational Trust Building Koinange Street 4 th Floor P.O Box 42833-00100, Nairobi Tel: 0728 494478 ceo@private-equitycompany.com
SACCOS			
44	Stima Sacco Society Ltd	Paul Wambua - CEO	Stima Sacco Plaza, Musembi Road, Parklands P.O. Box 75629-00200 Nairobi. info@stima-sacco.com
DEVELOPMENT INSTITUTIONS			
45	Swiss Contact	John Njoroge – Project Manager Veronique Su - Regional Program Director Financial Services	P.O. Box 47996 - 00100, Nairobi. Kenya 6th Floor , Victoria Plaza 11 Parklands Road , Westlands , Tel : +254 - 20 374 3927 or + 254 - 20 374 4042 info@swisscontact.co.ke www.swisscontact.co.ke jn@swisscontact.co.ke veronique@swisscontact.co.ke

Appendix IV: Factor and Principal Component Analyses (Pilot)

1. Factor Analysis for Transformation of Micro, Small and Medium Enterprises

Component Matrix		Component	
		1	
Our Institution has experienced an increase in total revenue collection in the last 5 years, which in turn has enhanced the transformation of MSMES	.844		
Our Institution has experienced an increase in assets over the last 5 years, which in turn has enhanced the transformation of MSMES	.807		
Our Financial and non – Financial services have contributed to the transformation of MSMES owned by our clients	.453		
Our Institution has experienced a positive Return on Investment (ROI) over the last 5 years and this has been good news to our MSMEs clients	.398		
<i>We have competitive advantage and superior performance over other MFIs when it comes to supporting our MSMEs clients</i>	.042		<i>Dropped</i>

2. Factor Analysis for Institutional Policies

Component Matrix		Component	
		1	
In this institution, written procedures and instructions are given a special importance with special focus on our MSMEs clients	.869		
Our Institution requires that all the information gathered about our clients is passed on to the credit operations for review	.758		
The credit operations unit does preliminary review of the completeness and consistency of the borrowers' data (MSMEs)	.684		
Our Institution collects comprehensive and current data on the economic and personal situation of the MSMES	.656		
Our Institution has a formal and written discipline policy to effectively support our MSMEs clients	.602		
<i>The credit department has a system in place of ensuring the loans to MSMEs clients are applied for the intended purpose</i>	.151		<i>Dropped</i>
<i>The credit department always examines the collateral status and capacity of the borrower (MSMEs) during credit review</i>	.060		<i>Dropped</i>

Extraction Method: Principal Component Analysis.

3. Factor analysis for Management Functions

Component Matrix

	Component 1
There is effective communication within our organization and with our clients (the MSMEs)	.866
Our organization's operations are always based on the developed strategic plan, with a specific focus on enhanced service to our customers	.853
There is clear division of duties and responsibility among employees with a clear focus on enhanced service delivery to our clients	.845
Managers in our organization take action on new and innovative ideas provided by employees to improve support to our clients	.763
Our management team is easily accessible by our clients (MSMEs) on business related issues	.682
There are well trained and experienced employees in the organization who deliver high quality service to our customers (the MSMEs)	.659

Extraction Method: Principal Component Analysis.

4. Factor Analysis for Human Resource Management

Component Matrix

	Component 1	
Our organization selects employees who can provide ideas to improve the operation process and adequately support our MSMEs clients	.893	
Incentive system in our organization rewards staff that accomplish work objectives with high satisfaction to clients	.812	
Our organization selects employees who are able to work well in work teams and effectively support our MSMEs clients	.810	
Training currently provided in our institution has transformative effects on the transformation of MSMEs that we serve	.747	
Our organization uses problem – solving aptitude and customer service as key criteria in employee selection	.635	
<i>The longer an employee has been at this institution, the more tasks or jobs that employee learns to perform and this leads to high quality service to our clients</i>	-.188	<i>Dropped</i>

Extraction Method: Principal Component Analysis.

5. Factor Analysis for Government Systems

Component Matrix	
	Component 1
Board sub-committees have led to better organizational performance that by extension has led to the transformation of our MSMEs clients	.848
The board decisions have impacted positively on the transformation of MSMEs	.838
The Board is composed of directors with varied and relevant knowledge and skills to the micro-financing industry and MSMEs sector	.766
Our Institution has board committees which consist of independent non-executives directors	.616
Our Institution has an overall board and independent board subcommittees in place to enhance effective monitoring and oversight capable of enhancing the transformation of MSMEs	.602
There is proper coordination and communication among the Board of Directors and with our clients	.551
Extraction Method: Principal Component Analysis.	

6. Factor Analysis for Financial Management Systems

Component Matrix		
	Component 1	
Our organization has a good revenue base built over time	.814	
The revenue base of our organization has greatly assisted MSMEs in expanding their businesses	.791	
Our organization has good cash management skills	.684	
The repayment period for the MSMEs loan is adequate	.452	
<i>The maximum loan amounts available to the MSMEs are adequate to support their business transformation</i>	.343	<i>Dropped</i>
<i>Our Institution charges reasonable interest rates on loans to MSMEs than other micro institutions</i>	.313	<i>Dropped</i>
<i>Our institution asks for low collateral requirements from MSMEs clients than other micro institutions</i>	.176	<i>Dropped</i>
Extraction Method: Principal Component Analysis.		