

**FINANCIAL DETERMINANTS ON MICRO FINANCE PERFORMANCE
IN KENYAN COAST: A CASE OF MICRO FINANCE COMMUNITY
BASED ORGANISATIONS IN JOMVU KUU**

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DECLARATION

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

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DEDICATION

I wish to dedicate this project to my husband, Abdulshakur Saad who supported me all through my learning process, my sons, Saad and Farouk and My daughter Aisha for their patience. I also appreciate my brother Mahmood Kaloo for his encouragement and support during writing of this project and the Wajomvu Welfare Association through the Chairman, Salim Muungwana and Coordinator, Mwichande Kombo for their support.

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ABBREVIATIONS/ ACRONYMS

CBO	Community Based organization
CGAP	Consultative Group to Assist the Poor
CMDP	Coastal Micro-Enterprise Development Programme
FSA	Financial Services Association
KAS	K-Rep Advisory Services
MFI	Microfinance institution
MPC	Marginal propensity to consume
MPT	Markowitz' portfolio theory
SS	Operation Self-sufficiency
PAR	Portfolio at risk
ROA	Return on Asset
ROE	Return on Equity
SPSS	Statistical Package for Social Sciences

DEFINITION OF TERMS

Microfinance	The provision of financial services primarily savings and credit to the poor and low income households that don't have access to commercial banks. (Arsyad, 2005).
Microfinance Community Based organization	is an organization which assumes greater significance, provides the possibility for the emergence of a viable option since it is non-exploitative, member-based and member-managed and, more importantly, the members benefit directly from the savings and the profits. (Srinivasan, 2010)
Performance Prism	The performance measurement based on five distinct but linked perspectives of performance: Stakeholder satisfaction, Strategies, Processes, Capabilities and Stakeholders contribution (Kennerley & Neely, 2000)
Entrepreneurship	A form of social relationships that contributes to economic and spiritual potential of any society, creates favorable conditions to practical

realization of individual capabilities and talents, and favors nation unity. (Pavlenko, 2001)

Portfolio at risk

The value of all loans outstanding that have one or more instalments of principal past due more than a certain number of days. This item includes the entire unpaid principal balance, including both past-due and future instalments, but not accrued interest. It also does not include loans that have been restructured or rescheduled (CGAP, 2005)

Dividend

The portion of a company's net earnings which the directors recommend to be distributed to shareholders in proportion to their shareholdings in the company (Pandey , 2001).

ABSTRACT

The main goal of every Microfinance Institution (MFI) is to operate profitably in order to maintain its stability and improve growth and sustainability. This study focused on the financial determinants of MFIs performance in Kenyan Coast. The survey study of Jomvu Kuu community based MFIs were preferred because the Wajomvu community used a particular type of micro-finance institution, the Financial Services Association (FSA) model under which local inhabitants owned and operationalized the institution. Descriptive research design was used with a target population of 65 members of Nanimo and Jumbe MFIs in Jomvu Kuu from which a sample of 60 members was identified. Questionnaires were used to collect primary data. The data collected was analyzed using descriptive statistics to determine the mean, standard deviation, minimum and maximum of the various variables. The findings indicated that loan and savings portfolio affects the performance of MFIs, this was because savings ensured liquidity of the MFIs and prudent allocation of loans Group lending, effective loan portfolio management and diversification of loan portfolio enhances the performance of MFIs. There was no direct relationship between the dividend policy and performance of MFIs as the role of microfinance institutions was poverty reduction and wellbeing improvement of the people who could not access financial service from commercial banks. Therefore, the management of the MFIs should identify innovative modes of

savings, seek for further financing, apply efficient and effective credit risk management and adopt a dividend policy in order to become more competitive.

CHAPTER ONE

INTRODUCTION

1.1 Background to the Study

Micro-finance refers to financial services such as cash loans, deposit savings accounts, and insurance made available in relatively small amounts to poorer populations throughout the developing world. Microfinance basically relates to all financial intermediation services such as savings, credit, funds transfers, insurance, pension and remittances among others by financial institution in both rural and urban areas to low income earners (Robinson, 2001). Microfinance promises both to combat poverty and to develop the institutional capacity of financial systems, through finding ways to cost-effectively lend money to poor households (Morduch, 2000). Three features distinguished microfinance from other formal financial products: the smallness of loans offered or savings collected the absence of asset-based collateral and the simplicity of operations (Seyed, 2011) .

Loan repayment which measured portfolio quality was an essential ingredient for sustainability of MFIs. Loan repayment indicators included Portfolio at risk (PAR), credit risk measured by the sum of the level of loans past due 30 days or more (PAR>30) is negatively and significantly related to MFI sustainability (Cooper, A. Jackson , M. J . Patterson, G. A., 2003). Increased exposure to credit risk resulted to lower MFI sustainability, given that credit granting was the principal source of revenue for these institutions. There was a positive influence of

the collection of deposits from clients in form of savings and also shares. Microfinance is primarily a cash-based operation and involves member's savings. However, to make the sorts of investment that stimulate endogenous economic growth, one needs access to financial capital that comes either from savings or from borrowing, which is difficult in environments where the formal means of either saving or borrowing are typically absent. Traditional communities had informal mechanisms for savings. For example, voluntary rotating savings and credit associations of various sorts are proliferating across Southeast Asia and Africa allowed individuals to receive periodic payouts from group contributions (Anthony, 2005).

Dividend policy also affected MFI performance in that it encouraged members to increase their deposits because in the end of the year the profits arising from the performance was shared in form of dividend. The more the savings the more dividends received. Dividend policy is the decision to pay out earnings versus retaining and reinvesting them. Dividend policy was considered to be one of the most important financial decisions that corporate managers encounter (Baker & Powell, 1999). It had potential implications for share prices and hence returns to investors, the financing of internal growth and the equity base through retentions together with its gearing and leverage (Omran & Pointon, 2004).

1.1.1 Financial Determinants of MFIs performance

According to Rosenberg (2009), MFIs performance measurements involved four core areas, outreach to poor, repayment rates, sustainability and efficiency. Empirical evidences on performance of microfinance institutions reported different results, most of them indicating variation of performance across types of MFIs. The study by Michael & Miles (2004) used financial metrics to compare performance of microfinance institutions with commercial banks operating in four regions Africa, Asia, Eastern Europe and Latin America.

The findings of the study showed that, MFIs that were operation self-sufficiency OSS had higher performance in terms of return on asset (ROA) and return on Equity (ROE). All these studies used financial metrics in the measurement of performance of microfinance institutions. Accounting profitability was used as a high standard measure of financial sustainability (Cull et al., 2007). The present study sought to look at different financial determinant of MFIs performance, these included loan portfolio, deposit portfolio and dividend policy. Loan portfolio management is the process by which risks that are inherent in the credit process are managed and controlled (IACPM, 2005). According to Khandker et al, (1995) loan repayment (measured by default rate) could be another indicator for financial sustainability of MFIs; because, low default rate would help to realize future lending. Therefore, credit portfolio management encompassed assessing the risk involved with each loan and then analyzing the total amount of risks for all loans.

The major objective of portfolio management was to reduce the amount of loans default and hence improve performance. One of the major innovations of microfinance was the reliance on group lending practices. Access to deposit services enabled the poor to better manage emergencies; smoothen consumption; met expected demands for large sums of cash, such as school fees; and take advantage of investment opportunities. For microfinance institutions (MFIs), deposit taking was the key to financial sustainability. Deposit mobilization provided a stable means to finance the growing loan portfolio; this ensured that MFIs do not depend on unreliable donor funds, government subsidies, and external credit. Deposits also fueled local development by increasing the resources available for productive Deposits portfolio helped in liquidity Management, Client deposits were invested in assets that match their term and pricing structure. For instance, if deposits were to finance the loan portfolio, highly liquid, short-term passbook savings accounts were not used to fund long-term housing loans (CGAP, 2005).

The issue of dividend policy is a very important one in the current business environment. Dividend policy remained one of the most important financial policies not only from the viewpoint of the company, but also from that of the shareholders, the consumers, employees, regulatory bodies and the Government. Dividend policy is the decision to pay out earnings versus retaining and reinvesting them. Dividend changes may be important signals if the market anticipates that the change will be maintained through time. If the market believes

that the change is just a rearrangement of dividends through time, then the impact will be small. The reaction to the information contained in dividend changes is called the information content effect. Dividend policy was considered to be one of the most important financial decisions that corporate managers encounter (Baker & Powell, 1999). It had potential implications for share prices and hence returns to investors, the financing of internal growth and the equity base through retentions together with its gearing and leverage (Omran, M. & Pointon, J., 2004). According to Mizuno (2007) a firm ought to distribute its earnings to shareholders if it cannot identify suitable investments which would bring higher returns than those expected by the shareholders.

According to Miller and Modigliani (1961) dividend irrelevance theorem a lower dividend payouts ratio was assumed to be associated with higher future growth and thus higher future equity returns. While determining retention and distribution of earnings, a prudent manager strikes a balance between shareholders expectations and firms' long-term interest. Enhancing shareholders wealth and profit making are among the objectives of a firm (Pandey, 2005). Shareholder's wealth is mainly influenced by growth in sales, improvement in profit margin, capital investment decisions and capital structure decisions (Azhagaiah and Priya, 2008). While the group mechanism lies at the heart of the microfinance model, a number of other practices have contributed to the success of MFIs. These practices were motivated by dual purposes augmenting the financial security of the bank, but also the welfare of the borrower. The profits earned by MFI was either ploughed back into

the expansion of its operations or used to subsidize investment instruments offered to borrowers or distributed as dividends to shareholders (who are also borrowers) – all actions which increased the bonds between MFI and its borrowers.

1.1.2 MFIs Community based organization

The Wajomvu community along the coast undertook microfinance programmes due to income arising from sea products and mangrove forests such as income from eco-restaurant, birding excursions, selling crabs and fish to hotels, honey products, pottery items, timber for construction and fuel wood. Mangroves played an important role in providing sources of income for households, particularly the poor, with direct use values and indirect use values of the mangrove. The women from the community relied much on pottery hence they used mangrove trees for burning the pots. They also engaged themselves in bee-keeping for honey products. The survey study of Jomvu Kuu community based MFIs was preferred because the Wajomvu community used a particular type of micro-finance institution, the Financial Services Association (FSA) introduced into coastal community of Kenya by Coastal Micro-Enterprise Development Programme (CMDP).

The programme through the facilitation of K-Rep Advisory Services (KAS) established and operationalized two financial delivery schemes. The affairs of the schemes were managed by management committees, managers/credit officers and financial committees who underwent training on financial management skills

conducted by KAS. Under the FSA model, local inhabitants owned and operationalized the institution, electing the Board of Directors and committees and deciding whether to reinvest profits or to distribute them to share owners like dividends.

The FSA mobilized local financial resources through share ownership and deposit-taking savings accounts for lending back to the community for productive investments. The idea was for FSAs to take advantage of informal local rules, customs, relationships, knowledge, and solidarity networks that are believed to increase loan repayment while introducing formal banking concepts and methods believed to improve allocation of scarce financial capital. Micro financing aimed to alleviate poverty by stimulating economic growth through entrepreneurial initiative. The industry has been growing in a significant rate and has become a sub-sector of the formal financial market in some countries (Hermes, 2010). Generally Microfinance provides Credit, Savings, Insurance and money transfer facilities to the people. CGAP, (2005) defined Microfinance as financial services for poor and low-income clients. In practice, the term was often used more narrowly to refer to loans and other services from providers that identify themselves as microfinance institutions (MFIs).

MFIs used group lending and liability, pre-loan savings requirements, gradually increasing loan sizes, and an implicit guarantee of ready access to future loans if present loans were repaid fully and promptly. According to Robinson (2001),

microfinance refers to small scale financial services primarily credit and savings-provided to people who farm or fish or herd, who operate small enterprises or small business enterprises where goods are produced, recycled, repaired, or sold; who provide services; who work for wages and commissions; who gain income from renting out small amounts of land, vehicles, draft animals, or machinery and tools; and to other individuals and groups at the local levels of developing countries, both rural and urban.

1.2 Statement of the Problem

Throughout the world, performance of microfinance institutions has been one of the issues that has recently captured the attention of many researchers. The Performance measure of MFIs has been a means for managing MFIs and a necessity for sustainability. (Kheder, Mustafa, Saat, 2013). Several studies have been conducted to determine factors affecting the performance of microfinance institutions using large and well developed MFIs in various countries. According to Cull et al. , (2007), some of the determinants are found to be significant in one economy or applicable to a set of MFIs, some are not significant. For the purpose of this study we reviewed empirical literature based on the influence of deposit portfolio, loan portfolio and dividend policy. The microfinance paradigms focus on reduction of poverty through improving access to finance and financial services. However, the positive impacts of microfinance institutions on the welfare of the poor can only be sustained if the institutions can achieve a good financial performance.

Several studies have also been conducted, as well, to determine factors affecting the performance of MFIs using large and well developed MFIs in various countries. The level of significant of these factors in affecting the performance of MFIs, however, varies with studies. Some of the factors are found to be significant in one economy or applicable to a set of MFIs, some are not significant. According to Kennerley and Neely (2000) Performance Prism considers the importance of stakeholder satisfaction.

Performance prism considers shareholder to remain the important stakeholders and realize that all stakeholders are not equally important. However, Performance Prism assumes more consideration should be given to other important stakeholder group, such as customers' employee, suppliers, regulators, legislators and pressure groups all of whom are not incorporated into the balanced scorecard the performance prism framework is based on five distinct but linked perspectives of performance: Stakeholder satisfaction, Strategies, Processes, Capabilities and Stakeholders contribution. However the Performance Prism falls short to consider other important factors that affect the running of an MFI. Moreover, studies done in Kenya have not exhaustively focused on all the factors influencing performance of MFIs.

The determinants of MFIs growth in Kenya as per Wachira (2013) , were the amount of investment, level of education for the participants and utilization of loans. Accordingly, the main objective of this study will be to investigate factors

that influence the performance of microfinance institutions in Kenyan coast. Three factors identified through a scan of relevant literature (loan portfolio, deposit portfolio and dividend policy) are hypothesized to influence MFI performance in Kenya.

1.3 Objectives of the Study

The study was guided by the following general and specific objectives.

1.3.1 General Objective

The broad objective of the study was to investigate the effects of financial determinants on the performance Microfinance community based organizations in Jomvu Kuu in Kenyan Coast.

1.3.2 Specific Objectives

1. To investigate the effects of loan portfolio on the performance of micro finance community based organizations.
2. To determine the effects of savings portfolio on the performance of micro finance community based organizations.
3. To investigate the effects of dividend policy on the performance of micro finance community based organizations.

1.4 Research Questions

1. What are the effects of loan portfolios on the performance of microfinance community based organizations?
2. What are the effects saving portfolios on the performance of microfinance community based organizations?
3. What are the effects of dividend policies on the performance of microfinance community based organizations?

1.5 Significance of the Study

The findings of this research helped the various stakeholders including self-managed, self-help groups and autonomous village banks to realize shortcomings that have been affecting the performance of MFIs. Members of these groups know one another and directly control operations. Hence no need of collateral when taking loans. Through the loan transaction process and savings deposit, borrowers develop their banking behaviors, through the whole process micro-borrowers are able to reduce their poverty (World Bank, 1996). In any company, shareholders as rational investors usually expect to receive some income as return on their investments.

The ability of a company to pay dividends will depend to a large extent on its financial performance. Lasher (2000) was right when he noted that a decrease in dividend is taken as terrible news. It generally comes after a sustained reduction in earnings and hence the importance of this study. This is because the findings of the

study will highlight to these parties how the financial determinants of MFIs will lead to better performance. The findings of the present study will also be invaluable to academia in Kenya.

1.6 Scope of Study

The study was carried out in the coastal region of Kenya, particularly in Mombasa County. The study focused on the community based MFIs in the county namely Jumbe and Nanimu. This being my target population. Information was gathered through the use of questionnaires and interview. The extent of the study was confined within the stated objectives. The study involved management committee and staff responsible for managing the activities of the MFIs. Proposal writing, collecting and analyzing data as well as presentation of the findings took twenty weeks.

1.7 Limitation

The major limitation of the study was that the respondents were reluctant to give information fearing that the information gathered may be used to intimidate them or resulted to a negative image about them. The researcher handled this problem by carrying with her an introduction letter from the University in order to assure the respondents that the information gathered was treated with confidentiality and used purely for academic purposes.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

In this chapter, the researcher presented the review of related literature to the subject of the study. Focus was put on the financial determinants affecting MFIs performance. This chapter specifically entailed theoretical framework, conceptual framework, empirical studies, critique of existing literature, research gap and as well as its summary.

2.2 Theoretical Framework

The theories absolute income hypothesis, Markowitz portfolio and dividend relevance: Bird-in-the-Hand served as a foundation to the proposed topic and the

ensuing discussion highlighted on the relationship and influence of these theoretical concepts in relation to the development of the conceptual framework.

2.2.1 Absolute Income Hypothesis

Savings as a subject has received immense publishing from different authors and schools of thought. Savings and consumption are normally considered together in most of the theories of savings, due to the fact that if a household makes a decision to consume, it is in effect making a decision not to save the consumed amount. Keynes (1936) was the first to develop a systematic theory of aggregate consumption expenditure by households. He assumed consumption expenditure to be a function of current disposable income. Keynes absolute income hypothesis is based on the psychological law, which states that “men are disposed, as a rule and on average, to increase their consumption as their income increases but not as much as the increase in their income” (Keynes, 1936). The marginal propensity to consume out of disposable income is positive and less than one. Household’s current consumption expenditure is a positive function of real current disposable income. As the income increases, the increment is partly consumed and partly saved for purposes of financial security in periods of unemployment, illness, death of bread winner or for investment so as to enhance future income. The absolute income hypothesis is a short run theory and makes the assumption that marginal propensity to consume (MPC) is between zero and one. MPC declines with increase in income, implying that marginal propensity to save increases as income

increases. The implication of this is that low income families save a lower percentage of their income as compared to high income families.

2.2.2 Markowitz Portfolio Theory

The Markowitz portfolio theory states that an investor should choose a portfolio from the efficient set depending on how risk averse he/she is. The aim of portfolio optimization is maximizing the income of portfolio, simultaneously minimizing the risk. (Markowitz, 1952). The most important aspect of Markowitz 'model was his description of the impact on portfolio diversification by the number of securities within a portfolio and their covariance relationships (Megginson, 1996). The terms 'diversification' and 'Diversification Effect' refer to the relationship between correlations and portfolio risk. Diversification, a cornerstone of Markowitz' portfolio selection theory (MPT), is a risk reduction concept that involves the allocation of investments among various financial instruments, industries and other investment categories. The objective of diversification is to maximize returns and minimize risk by investing in different assets that would each react differently to the same event(s).

2.2.3 Dividend Relevance: Bird-in-the-Hand Theory

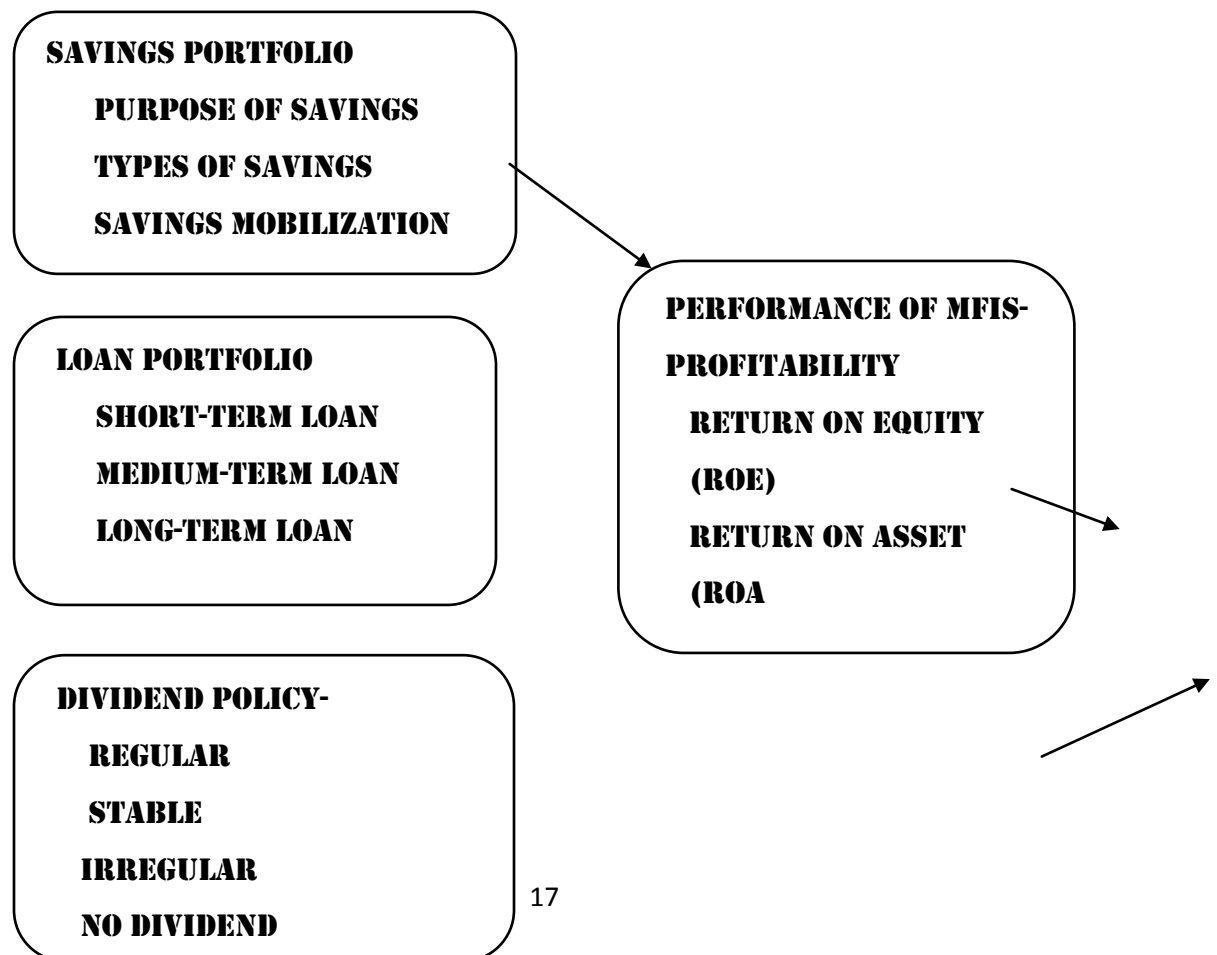
The bird-in-the-hand theory, hypothesized independently by Gordon (1963) and by Lintner (1962) states that dividends are relevant to determining of the value of the firm. In a popular common stock valuation model developed by Gordon. Bird in hand theory proposes that a relationship exists between firm value and dividend

payout. The essence of the bird-in-the-hand theory of dividend policy argues that outside shareholders prefer a higher dividend policy. Investors think dividends are less risky than potential future capital gains, hence they like dividends. If so, investors would value high payout firms more highly. Hence, the bird-in-the-hand theorem suggests that the relationship between dividend policy and the firm's value can be explained by investors' preference for dividend payments rather than the expected capital gains from stocks. This preference exists because dividends represent a sure thing, being less risky than the expected capital gains. However, MM argue that the riskiness of the firm depends on the riskiness of the operating cash flows and not on its dividend payout policy.

In addition, tax preference theory comes from the favorable tax treatment of capital gains relative to dividend payments. This leads investors to prefer firms with lower payout ratios rather than firms with relatively high dividend payout ratios. The dividend yield and the future growth of the dividends provide the total return to the equity investor. The Assumptions of the Bird-in-the-Hand theory fits in the performance of MFIs because an MFI is an all equity firm since it relies on members' savings and it has no debt in its capital structure, also No external financing is available and consequently retained earnings are used to finance any expansion of the firm.

2.3 The Conceptual Framework

A conceptual framework assists the reader easily to connect the relationship of the various variables in a study (Mugenda & Mugenda, 2003). This section discussed the conceptual framework on the financial determinants on microfinance performance. It consists of independent variables (savings portfolio, loans portfolio and dividend policy) and the dependent variable (Performance of MFIs). The variables are the building blocks of theory in a research. This is represented in the figure below.



Independent Variable

Dependent Variable

Figure 2.1: Conceptual Framework

2.3.1 Saving Portfolio

Transforming microfinance institutions from depending on the government grant and donor funds into self-sufficient has accompanied with the needs to diversify their products and consolidate their market share. In order to achieve that, microfinance institutions have been tailored saving products to relieve unexpected shocks that maybe face poor and enhance their repayment rate as well as support the financial position of microfinance institutions. There are different types of savings services that are offered by MFIs such as insurance, deposits, compulsory and voluntary and others. However, the most common ones are voluntary and mandatory savings.

Mandatory saving is referred to the value of savings that the clients of microfinance are required to save as a condition of obtaining future loan. Mandatory savings can be either a facilitated savings account kept outside of the MFI or a deposit held by an MFI. In contrast, voluntary savings is referred to the amount of savings kept by MFI clients which is not required as a condition of an

existing to loan. Voluntary savings can be facilitated savings which kept outside the MFI as part of the MFI's overall financial services or deposits held by an MFI. Robinson (2001) indicated that the advantages of saving service can be read from the perspective of the clients as well as microfinance institutions. On one hand, saving services are a valuable mechanism to clients for liquidity management through accessibility to cash, rate of return, security and divisibility of savings.

On the other hand, savings are vital and attractive source to microfinance for three reasons: - (a) important source for microfinance funds which can be easily obtained with lower cost, (b) withdrawals small amounts of money from saving account do not lead to liquidity risk compare to large savings, (c) small deposits and savings are more steady capital source than re-deducted it from the Central Banks or donor funds. (d) deposit-taking can create strong market-demand for microfinance institutions and improve their operations. Savings products are also important to poor which help them to reduce the financial cost of lending and secure a sustainable fund sources (Robinson, 2001).

2.3.2 Loan portfolio

According to Araya and Christen (2004), at least 80 per cent of the needs of the poor are actually derived from biological resources. Because they rely heavily on natural resources for survival, the poor are the most affected by environmental degradation (Hall, et al., 2008) .The contamination or overexploitation of natural resources can directly translate into the loss of inputs for their various activities,

the loss of an income-generating opportunity Benjamin & Wilshusen (2007) the loss of a risk-coping mechanism natural resources are often used by poor households as a safety net in case of shocks), increased conflicts over scarce resources or increased vulnerability to natural disasters. Portfolio quality means MFIs ability to control, monitor and ensure repayment from its clients. The loss of income generating opportunity will lead to reduction in loan portfolio which will in the end affect the performance of MFIs.

Loan portfolio is the total of all loans held by a bank or finance company on any given day. Therefore, individual loans form a loan portfolio in MFI. Moreover, the size of loan portfolio depends on the size the individual loan which is also influenced by the economic status of the borrowers in a particular location. The loan portfolio is typically the largest asset and the predominate source of revenue. As such, it is one of the greatest sources of risk to a bank's safety and soundness. Loan portfolio in MFIs is the most important since portfolio quality reflects the risk of loan delinquency and determines future revenues and ability to increase outreach and serve existing customers.

Survival of most MFIs depends entirely on successful lending program that revolves on funds and loan repayments made to them by the clients (Sindani, 2012). This requires a restrictive credit control system to be put in place so as to restrain from unnecessary lending thus, improving on profitability of micro finance institutions (Kakuru, 2000). Credit management is the executive

responsibility of determining customer's credit ratings as part of the credit control function. Rosenberg (2009) argued that client delinquency is considered to be an important correlate of MFI loan default. Effective management loan portfolio and credit function is fundamental to a MFIs safety and soundness. Loan portfolio management is the process by which risks that are inherent in the credit process are managed and controlled. Good loan portfolio managers have concentrated most of their effort on prudently approving loans and carefully monitoring loan performance.

Nawai and Shariff (2010) revealed that the group lending is effective loan portfolio management in their paper which reviewed the literatures describing the determinants of repayment performance in microcredit programs. Wood (2004) asserted strategies that can optimize the portfolio value include diversification for reducing risk, having adequate sources of funding, balancing the mixture of assets to provide growth and to operate efficiently so as to optimize the cash flow.

2.3.3 Dividend Policy

Dividend policy is the regulations and guidelines that a company uses to decide to make dividend payments to shareholders (Nissim & Ziv, 2001). Dividend, which is basically the benefit of shareholders in return for their risk and investment, is determined by different factors in an organization. Firms ought to distribute their earnings to shareholders if they cannot identify suitable investments which would bring higher returns than those expected by the shareholders Mizuno (2007) the

amount of dividends distributed to shareholders or members in cash. These distributions should be made from Retained Earnings.

2.3.3.1 Regular Dividend Policy

Regular dividend policy is based on the payment of a fixed – dollar dividend in each period. The policy provides owners with generally positive information, thereby minimizing uncertainties. Payment of dividend at usual rate is termed as regular dividend. The investor such as retired persons, widows, other economically weaker persons prefer to get regular dividend. The regular dividend can be maintained only by the company of long standing and stable earnings. A company should establish the regular dividend at a lower rate as compared to average earnings of the company.

A policy to pay regular and extra dividends is adopted by MFIs in the period they accumulate higher profit and thus share extra profit as extra dividends instead of increasing the regular dividend payout ratio. This policy takes the company's investment opportunity schedule, target capital structure and the cost of capital raised externally into consideration. By paying dividends to shareholders, free cash flows are reduced and thus managers have no opportunity to make suboptimal investments (Bartram, 2009). It provides stockholders with positive information indicating that the firm is doing well and it minimizes uncertainty. A firm's value and performance is therefore enhanced through higher returns from optimal investments.

2.3.3.2 Stable Dividend Policy

The stability of dividend means consistency in the stream of dividend payments. It means payment of certain minimum amount of dividend regularly. A stable dividend policy may be established in Constant Dividend per Share and Constant Payout Ratio. While using the Constant Dividend per Share, Some companies follow a policy of paying fixed dividend per share irrespective of the level of earning year after year. Such firm creates reserves i.e. dividend equalization reserves to enable them to pay the fixed dividend even in the year when the earnings are not sufficient or when there are losses. The policy of constant dividend per share is more suitable to concerns whose earnings are stable over a no: of years. The Constant Payout Ratio means payment of fixed percentage of net earnings as dividend every year. The amount of dividend in such policy fluctuates in direct proportion to the earnings of the company.

The policy of constant payout is preferred by the firm because it is related to their ability to pay dividends. By management having a stable dividend policy it tends to avoid sending a signal that might be misinterpreted by shareholders as though the firm is performing badly, however a firm should change its dividend policy in relation to shifts in earnings (Baker, Veit, & Powell, 2001). MFIs preferred a stable dividend payout ratio because the shareholders expect it and reveal a preference for it. many firms simply opt for a stable dividend policy and base current dividends on the previous year's dividend . Stable Dividend policy

affects the performance of MFIS. This is because Shareholders may want a stable rate of dividend payment for a variety of reasons. Risk averse shareholders would be willing to invest only in those companies which pay high current returns on shares. There is a positive relationship between testable dividend policy and the performances of MFIS .Community Based MFIS members are partly or fully dependent on dividend to meet their day-to-day needs.

2.3.3.3 Irregular Dividend Policy

This policy is followed when there is uncertainty of earnings, unsuccessful business operations, lack of liquid resources, and fear of adverse effects of regular dividend on the financial standing of the company. A policy of irregular dividends is adopted where earnings are unstable and management considers that shareholders are entitled to dividend only when the earning and liquidity positions of the banks warrant it “larger the earning higher the dividend and vice versa

According Moh'd, Perry, and Rimbey (1995) firms with unstable earnings pay fewer dividends. They use the irregular dividend policy. It is possible that the lower ratio is an attempt to keep dividend payouts stable and/or a way to avoid outside financing. Earnings volatility will have a negative relationship with dividend yield and hence affecting the performance of MFIs.

2.3.3.4 No Dividend Policy

A company may follow a policy of paying no dividends presently because of its unfavorable working capital position or on account of requirements of funds for future expansions and growth. A policy of no immediate dividends is adopted by new and rapidly growing MFIs, who need resources for expansion and diversification. This policy is employed by MFIs which have a large percentage of wealthy members and also to avoid payment of taxes. Cash dividends are taxed at the same rate as capital gains, this strategy benefits owner through tax deferral rather than as a result of a lower tax rate. This type of policy will affect the performance of MFIs.

2.3.4 Performance of community based MFIs

Performance of MFIs is viewed from the perspective of microfinance sustainability. Sustainability of a program indicates permanency in realizing the intended goal of the program. Providing microfinance is a costly business due to high transaction and information costs. At present, a large number of programs still depend on subsidies to meet high cost that is, they are not yet sustainable. The objectives of microfinance are to empower societies from an economic and social perspective by providing access to financial services, such as credit, savings and insurance facilities. The elements of the conceptual framework include

Performance of MFIs as the dependent variable which was measured by the profitability and growth. Profitability and sustainability ratios reflect the MFI's ability to continue operating and grow in the future.

Most reputable MFIs are striving for sustainability, regardless of their nonprofit or for-profit status; donors and investors alike look to fund sustainable institutions. Several factors can affect profitability and sustainability. Although startup or rapidly growing institutions may have low profitability, they are building the basis for a sustainable future. The ratios recommended in this section are the most widely accepted in the industry. Profitability is a type of performance measure which focuses on the relationship between revenues and expenses and on the level of profits with relative to the size of investment in the business (Zhou and Ruland, 2006). Four most commonly noted measures of firm profitability are: the rate of return on firm' total assets (ROA), the rate of return on firm's equity (ROE), operating profit margin and net firm income. In a for-profit MFI, Return on Equity (ROE) is the most important profitability indicator; it measures an MFI's ability to reward its shareholders' investment, build its equity base through retained earnings, and raise additional equity investment.

For a non-profit MFI, ROE indicates its ability to build equity through retained earnings, and increased equity enables the MFI to leverage more financing to grow its portfolio. By excluding donations and non-operating revenues, this ratio demonstrates an institution's ability to globally, women constitute the majority of

microfinance clients, primarily because of their better repayment records. This also makes them a particular target group for microfinance activities in fishing communities. It is recognized that women play an important role in fishing communities, encompassing social and economic responsibilities and duties, both within and outside their households. Women are involved in productive activities directly related to fisheries production, processing and marketing as well as in non-fisheries livelihood activities that are very important in augmenting household income during periods of scarcity and seasonality often experienced in fishing communities. Because of women's multiple roles and demands on their time, they are more involved in trading/vending and marketing activities to generate continuous earnings to make up for the seasonal nature of their husbands' incomes. Loan size requirements are small, which makes them appropriate clients of microfinance.

Other features of microfinance, such as no collateral, easy documentation requirements and simplified procedures benefit women who have had to face some barriers to access credit in the past. Women's involvement in microfinance has been shown not only to benefit them personally but their households and the community as well. Because they spend more of their income on their households, the welfare of their families is enhanced, thus generating a multiplier effect. Targeting women in microfinance programmes in fisheries is like investing in their empowerment and improving the well-being of their families and communities.

2.4 Empirical Studies

Asiedu-Mante (2002) asserted that very low deposits and high default rates have plunged some rural banks into serious liquidity problems, culminating in the erosion of public confidence in these rural banks/MFIs. He indicated further that a combination of poor lending practices and ineffective monitoring of credit facilities extended to customers has contributed to high loan delinquency in some banks. The performance of MFIs is highly affected by savings portfolio because it ensures liquidity. Consistent with Cull,et al. (2007) , MFIs should therefore broaden their services toward offering (more) deposits. This is important as it would also broaden the lending capacity of MFIs hence contributing towards better performance. Rosenberg (2009) stated 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).

Efficiency and productivity ratios are used to determine how well microfinance institutions streamline their credit operations. He also noted that microfinance institutions need to employ a combination of performance indicators such as profitability, operating efficiency and portfolio quality indicators to measure their

overall performance. Silikhe (2008) on credit risk management in microfinance institutions in Kenya found out that despite the fact that MFI's have put in place strict measures to credit risk management, normal loan recovery is still a challenge to majority of the institutions. This explains the reasons why most financial institutions are either not growing or about to close down. Bird in hand theory proposes that a relationship exists between firm value and dividend payout. It states that dividends are less risky than capital gains since they are more certain. Investors would therefore prefer dividends to capital gains (Amidu, 2006). The behavior of dividend policy is one most debatable issue in the corporate finance literature and still keeps its prominent place both in developed and emerging markets (Hafeez & Attiya, 2009).

Financial performance can also be measured in terms of net earnings which are divided into two parts, that is, retained earnings and dividends. The retained earnings of the business may be reinvested and treated as a source of long-term funds. The dividend should be distributed to the shareholders in order to maximize their wealth as they have invested their money in the expectation of being made better off financially. According to Amidu (2007). Dividend policy affects firm performance especially the profitability measured by the return on assets. Therefore, dividends have no explanatory power to predict future earnings. This research therefore tries to establish whether a relationship exists between dividend payout and firm performance.

2.5 Critique of the Existing Literature Relevant to the Study.

The existing literature mainly explained on the financial determinants and outreaches factors affecting the performance of MFIs. According to Churchill (2000), enhancing customer loyalty in a microfinance institution is the most important business strategy to enhance performance. Every critical element involved in managing microfinance operations , from product pricing to staff incentives, from marketing to eligibility requirements, from client screening to the menu of available services can (and should) be formulated to promote loyalty.

While most MFIs recognize the importance of client retention, few have designed business strategies to maximize customer loyalty. Schreiner discusses the role of credit scoring in MFIs and argues that scoring can add value to the MFI process. Lowe & Talbot (2000) critique the British Small Business Service's efforts in spurring microfinance and micro business development. They specifically focus on how the Small Business Service can improve its policies to support provision for rural micro businesses. As with most issues in microfinance, the effectiveness of microfinance as a policy tool for poverty alleviation and the optimal regulatory context for MFI development are still open questions. Researching these issues has the potential to be a rich area for discovery.

However the myriad of articles, journals, web publications, and books on Income generating units formed the foundation for my research. This study helped theoretically and empirically in providing answers to the research problems and therefore getting meaningful conclusions.

2.6 Summary

The summary section includes the relevant specific and generic literature on performance of MFIs that will form a basis for the future chapters. The literature review outlined the need to adopt effective loan portfolio management, saving portfolio management and dividend policy in order to enhance the performance of MFIs. Savings are a valuable mechanism for liquidity management.

MFIs have the appeal of bringing financial power to the people who need it most and whose resourcefulness and ingenuity it will fuel. MFIs have diversified their products through savings, Loans hence more customer recruitment and retention. The relationship between diversification and performance, lead to payment of dividends to members who have benefited from loan and saving facilities. The literature reviewed showed that some of the determinants are found to be significant in one economy or applicable to a set of MFIs, some are not significant.

Transforming microfinance institutions from depending on the government grant and donor funds into self-sufficient has accompanied with the needs to diversify their products and consolidate their market share. The previous empirical studies that have been looked at have concentrated mainly in developed countries. In developing countries, such as Kenya, few studies have analyzed the financial determinants affecting MFIs performance. This research looks at the issue from a developing economy point of view.

2.7 Research Gap

This study strives to establish the financial determinants of the performance of MFIs. Most of the benchmarking literature on MFIs performance is based the progress in cultivating self-sufficiency among those in abject poverty, and practically from the viability and high loan repayment rates of many microfinance institutions. MFIs performance measurements involved four core areas, outreach to poor, repayment rates, sustainability and efficiency (Rosenberg, 2009).The importance of stakeholder satisfaction was views as the main factor affecting performance (Kennerley and Neely, 2000). Given the significance of MFIs to the world economy and especially to the Kenyan economy this study proposed to bridge the knowledge gap concerning MFIs performance through increasing loan and savings portfolio and employing dividend policy to the members ,an area that had received little focus to date.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter presents the methods that were used to conduct the study. It specifically dealt with the research design, sampling frame, sample and sampling technique, the research instruments, data collection procedures and data analysis

techniques. This research was conducted at the Nanimu and Jumbe MFIs in Mombasa.

3.2 Research Design

The study employed a descriptive design because such a design allowed simultaneous description of views, perceptions and beliefs of the respondents at any single point in time (White, 2000). This technique was considered appropriate because it enabled the researcher to obtain factual information from the respondents. Descriptive study was ideal in that it provided the researcher a profile to describe relevant aspects of the phenomenon of interest from an individual, organizational, industry-oriented, or other perspective (Sekaran & Bougie, 2011). As such, descriptive studies present data in a meaningful form thus helps to understand the characteristics of a group in a given situation, think systematically about aspects in a given situation, offer ideas for further probe and help make certain decisions.

The researcher interviewed the management committee, credit committee CBO representative and staff working for the MFIs. A cross sectional study was also used to determine the interrelationship between the variables under consideration among two different firms in the study and this allowed the researcher to make statistical inference on the broader population, to include MFIs, and generalize the findings to real life situations and thereby increase the external validity of the study.

3.3 Population of the Study

Population of a study is the total number of the subjects of interest to the researcher (Oso & Onen, 2005). A target population is the population to which a researcher wants to generalize the results of a study (Kothari, 2003). The target population in this study consisted of 65 members of the community based MFIs in Mombasa County. The target population composed of Board of Directors, Executive Credit Committee members, Internal Auditors, FSA Manager, Loans Officer, Cashier and security personnel, Management Committee, Credit Committee and CBOs representatives

3.4 Sampling Frame

According to Groves (2009), a sampling frame is the set of source materials from which the sample is selected. The definition also encompasses the purpose of sampling frames, which is to provide a means for choosing the particular members of the target population that are to be interviewed in the survey. The sampling frame of the study was the members and staff of the two MFIs, Jumbe and Nanimu. Purposive sampling was used to interview the management committee members, credit committee members, CBOs members and staff.

3.5 Sample and Sampling Technique

Sampling is the procedure the researcher used to gather people, places or things to study. It was a process of selecting a number of individuals or objects from a population such that the selected group contains elements representative of the

characteristics found in the entire group, (Orodho & Kombo, 2002). The information derived from the resulting sample was customarily employed to develop useful generalizations about the population.

Table 3.1 Sample Size per Category

CATEGORY	POPULATION	SAMPLE SIZE	PERCENTAGE
BOARD OF DIRECTORS	9	8	14%
MANAGEMENT COMMITTEE	12	10	18%
CREDIT COMMITTEE MEMBERS	12	10	18%
CBOS REPRESENTATIVES	21	19	34%
STAFF	11	9	16%
TOTAL	65	56	100%

Justification of sample size

$$n = \frac{N}{1+N(e^2)}$$

Slovin’s sampling table (Umar, 2005)

Where: *n* is the sample size, *N* is the population size and *e* is the level of precision at 95% confidence level and ±5% precision.

$$n = \frac{65}{1+65(.05^2)} = 56$$

The researcher determined statistically viable sample size for the study, by the adopting the previous work of Yamane (1967), to suit the case MFIs. Stratified

random sampling technique was used. A stratified random sample is a random sample in which members of the population are first divided into strata, and then are randomly selected to be a part of the sample. Stratified sampling was used with size of the firm as the basis of the stratification.

3.6 Research Methods

The study employed the use of questionnaire as the main instrument for carrying out the survey. Both open and closed questionnaires were used to gather the required information from the key respondents who included Board of Directors, the Executive Credit Committee members, and Internal Auditors, FSA Manager, Loans Officer, Cashier and security personnel of Nanimu and the Management Committee, Credit Committee and CBOs representatives and staff of Jumbe. From preliminary investigations done all the respondents in the target population had adequate educational background hence in a position to respond to questionnaires' favorably.

3.7 Data Collection Procedure

The study used both primary and secondary data. Primary data was collected directly from the Management Committee and staff of the two MFIs through the use of questionnaires. Secondary data included information from documents such as brochures, strategic plans, and journals obtained from the MFIs. The researcher dropped the questionnaires physically at the respondents' place of work. The researcher left the questionnaires with the respondents and picked them up later.

Each questionnaire was coded and only the researcher knew which person responded. The coding technique is only used for the purpose of matching returned, completed questionnaires with those delivered to the respondents

3.8 Pilot Testing

The researcher carried out a pilot study to pre-test the validity and reliability of data that was to be collected using the questionnaire. Validity is defined as the degree to which a test measures what it is supposed to measure (Key, 1997). The tendency towards consistency found in repeated measurements is referred to as reliability (Bryman & Bell, 2003).

The researcher selected five board members from the target sample for pilot testing to test the reliability of the research instrument. The pilot study was allowed for pre-testing of the research instrument. The clarity of the instrument items to the respondents was necessary to enhance the instrument's validity and reliability. The aim was to correct inconsistencies arising from the instruments, which were to ensure that they measure the intended. The pilot data was not included in the actual study.

3.9 Data Processing and Analysis

Quantitative data collected was analyzed with the Statistical Package for Social Sciences (SPSS). SPSS is commonly used in survey research and deployment especially of statistical analysis. Data was analyzed on the basis of descriptive statistics. Descriptive analysis involves tabulation of data, graphing and description of data collected from the sample on a given research (Sekaran, U. & Bougie, R, 2011). Arithmetic mean, median, maximum, minimum and the standard deviation are some of the main descriptive statistics applied in data analysis.

CHAPTER FOUR

DATA ANALYSIS, PRESENTATION AND INTERPRETATION

4.1 Introduction

This chapter discusses the analysis of data collected from respondents. It involved scrutinizing the acquired information from the survey and making inferences. The findings were represented based on the objectives of the study. Results these were presented in the form of tables and others graphs showing frequencies and percentages.

4.1.1 Response Rate

The overall response rate was 54 out of 56 questionnaires giving a response rate of 96.4 %. This response rate was adequately sufficient as it conformed to the stipulation that a response rate of 50 % is adequate for analysis and reporting; a rate of 60 % is good and a response rate of 70 % and over is excellent (Mugenda, & Mugenda, 2003).

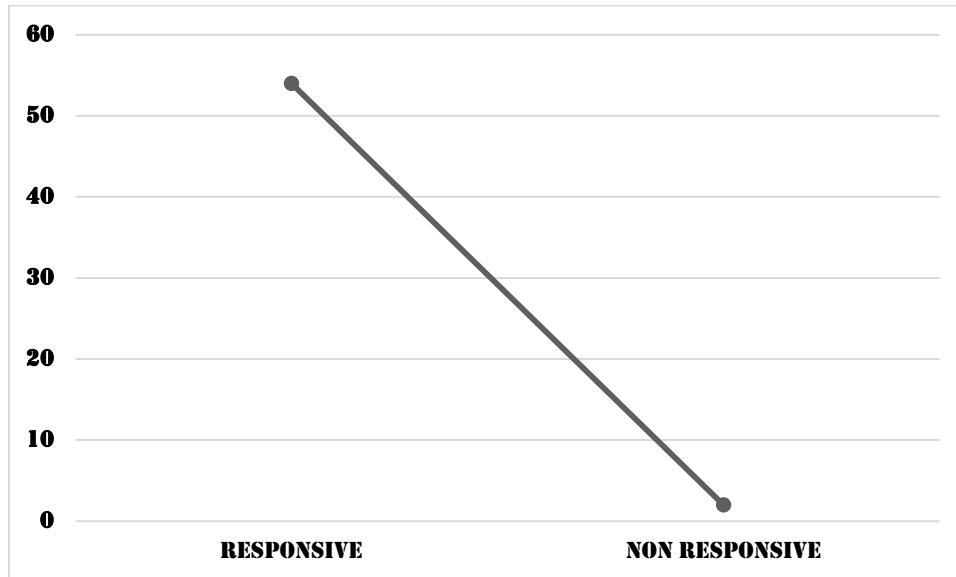


Figure 4.1: Response Rate

4.1.2 Demographics Characteristics

In this section the researcher sought to establish the demographics of the respondent's in terms of gender, age, level of education, occupation, and level of income. This being a sample study, all the views from respondents were merged.

Table 4.1 Gender

GENDER	FREQUENCY	PERCENTAGE
MALE	18	33.3
FEMALE	36	66.7
TOTAL	54	100.0

In the above table 4.1 the researcher sought to know the gender for the respondents. From the finding majority of respondents were female with the frequency of 36 out of a total of 54 and a 66.7 percent response rate. The responses for female were 18 with 33.3 % response rate, this indicates that majority of the board members and staff running MFIs are female. The bar graph below shows the percentages of the response rate:

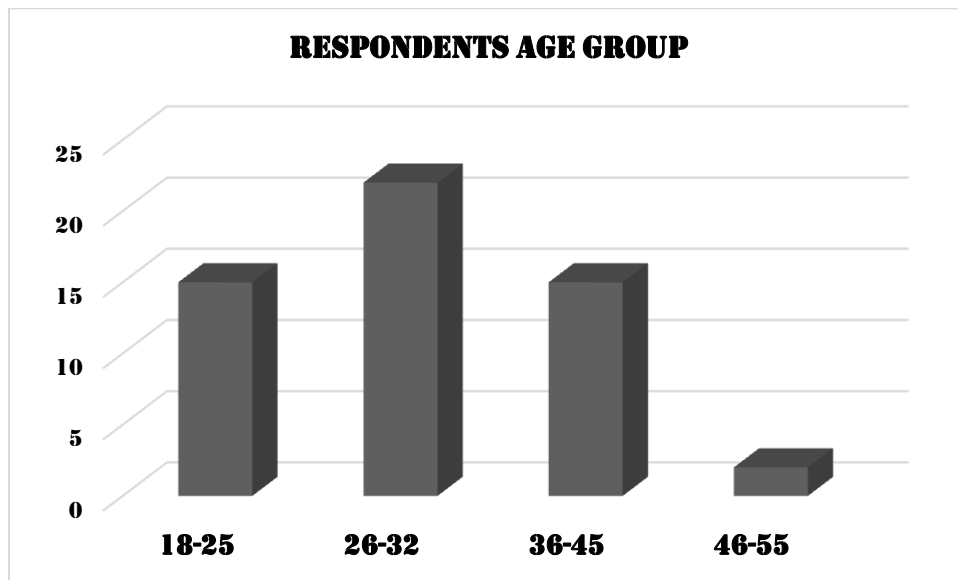


Figure 4.2: Respondents Age Bracket

On the age bracket of the respondents, majority (22) (40.7 %) were in the category of 26-35 years followed by (15) (27.8 %) in the category 18-25 and 36-45 years while (2) (3.7 %) at the category of 46 to 55 years .The information indicates that majority of the MFIs board members and staff in the Kenyan Coast are relatively young.

4.1.1 Level of education

Education is one of the most important characteristics that might affect the person's attitudes and the way of looking and understanding any particular social phenomena. In a way, the response of an individual is likely to be determined by his educational status and therefore it becomes imperative to know the educational background of the respondents. Hence the variable 'Educational level' was investigated by the researcher and the data pertaining to education is presented in Table 4.2.

Table 4.2 Level of Education

LEVEL OF EDUCATION	FREQUENCY	PERCENTAGE
POST GRADUATE	2	3.7
GRADUATE	6	11.1
DIPLOMA	10	18.5
CERTIFICATE	18	33.3
HIGH SCHOOL	8	14.8
PRIMARY SCHOOL	10	18.5
TOTAL	54	100.0

Table 4.2 shows that about 15 per cent of the respondents were educated up to graduate level and relatively lesser number of them, 85 per cent below graduate level. The number of respondents attaining higher education was very few. Only

four per cent of the respondents were educated up to the post graduates level. A considerable number of respondents were just functionally literates.

This analysis has shown that operating a microfinance institution require knowledge hence all the member and staff of the MFIs were progressive in education but they were still far away from the higher education which is so important today to create a knowledge based society.

4.2 Savings

The respondents were requested to investigate the effects of savings portfolio on the performance of micro finance community based organization using the 4-point Likert scale. The questionnaire comprised 5 options which the respondents were required to rate. The options for benefits of savings were captioned as in the table 4.3 below.

Table 4.3 Benefits of Savings

BENEFITS OF SAVINGS	N	MEAN	STD. DEVIATION
SAVING SERVICES ARE A VALUABLE MECHANISM FOR LIQUIDITY MANAGEMENT	54	2.22	1.298
LOWER COST SOURCE OF FUNDS	54	1.72	.452
SOURCE OF CAPITAL THROUGH SMALL DEPOSITS AND SAVINGS	54	1.85	0.359
DEPOSIT-TAKING CREATE STRONG MARKET-DEMAND	54	2.50	1.077
SAVINGS ACCUMULATION IS AN IMPORTANT TOOL FOR BUSINESS GROWTH	54	1.87	0.339
VALID N (LIST WISE)	54	2.032	

From Table 4.3 the results obtained from the survey on the respondents level of agreement on the effects of savings portfolio on the performance of micro finance community based organization show that the average mean response was 2.032 which implies a level of agreement given the scale range from 4 to 1, 4 being strongly Agree while 1 being too low. Means for each questions ranged from 2.5

to 1.72. Table 4.3 indicates that the Lower cost source of funds and Savings accumulation do not sufficiently meet the needs of the savings portfolio, while saving services being a valuable mechanism for liquidity management and deposit-taking being a strong market-demand for microfinance institutions are two benefits of savings which affect the performance of MFIs.

4.2.1 Types of Savings

The respondents were requested to state the types of savings which enhance performance of MFIs

Table 4.4 Types of Saving

TYPES OF SAVING	FREQUENCY	PERCENT
VOLUNTARY	20	37.0
BOTH VOLUNTARY AND MANDATORY	34	63.0
TOTAL	54	100.0

Savings mobilization in MFIs has become an integral part of a viable microcredit delivery system. From the study both voluntary and mandatory savings are the types employed by the MFIs. Insurance savings has not been used by the MFI.

4.2.2 Savings Mobilization

Savings Mobilization is the ratio of total deposit to gross loan portfolio. Gross loan portfolio means the total outstanding (not yet repaid) amounts of all loans. It was

included as an independent variable since savings mobilization in MFIs has become an integral part of a viable microcredit delivery system.

Table 4.5 Descriptive Statistics for Savings Mobilization

DESCRIPTIVE STATISTICS	
MEAN	1.299
MINIMUM	0.013
MAXIMUM	28.178
STD. DEVIATION	3.941

Savings mobilization measures the capacity of these institutions in mobilizing resource. A mean of 129.99% proved that MFIs are efficient in terms of savings mobilization hence improve the performance of MFIs. Microfinance institutions savings are a valuable mechanism to clients for liquidity management through accessibility to cash, rate of return, security and divisibility of savings (Robinson , 2001).

4.3 Loan Portfolio

Loan portfolio in MFIs is the most important since portfolio quality reflects the risk of loan delinquency and determines future revenues and ability to increase outreach and serve existing customers. Effective performance of loans is a product of performing loans. A performing loan is loan which is not in default, or is not

about to be, with a reasonable expectation that the loan will not enter default even though it has not technically defaulted yet is a performing loan. Loan policies define the type of loans offered, loan terms, interest rate policies, loan ceiling and concentration limits.

The variable type of loans was a very important performance indicator. Godquin (2004) reported that both age and size of loans have an inverse relationship to repayment performance. Furthermore, loans that are too big also lead to repayment problems dissatisfaction and high dropout (Hietalahti & Linden, 2006). A short-term loan in MFIs is one that is repayable within a period of one year. A long-term loan on the other hand, is any loan with payment terms extending beyond one year. In this study, the loan portfolio was measured by the type of loans employed by the MFIs, repayment period and the purpose for that loan.

Table 4.6 Types of Loan and Repayment Period

TYPES OF LOAN	AMOUNT	REPAYMENT PERIOD	PERCENTAGE
SHORT-TERM	BELOW 50,000	12 MONTHS	74.1
MEDIUM-TERM	50001-100,000	24 MONTHS	14.8
LONG-TERM	100,001-ABOVE	36 MONTHS	11.1
TOTAL			100.0

There is positive relationship between short-term loan and performance of MFIs supporting the findings of Bragg, (2010) who asserted that the short time frame reduces the risk of non-repayment to the bank. This is because the smaller the loan the lower the defaulting while when the long-term loan has a negative effect on performance supporting the findings of Hietalahti and Linden (2006) that loans that are too big also lead to repayment problems, dissatisfaction and high drop-out rates. Compared to short-term loans, Medium-term also have loans have a negative relationship with performance.

The findings shows that a short-term loan in MFIs is one that is repayable within a period of one year while a medium term loan is payable within a period of two years. A long-term loan on the other hand, is any loan with payment terms extending beyond three years.

4.3.1 Active Borrowers

The number of active borrowers was determined by the researcher, as per figure below majority of borrowers were women. Through MFIs, women achieved multiple productive activities and diversify their sources of income more than men. Thus, a higher percentage of female borrowers also indicate more depth of outreach, because lending to women generally is related to lending to the poor (Hermes, 2010). As per Table 4.7, the active borrowers were women compared to men with a percentage of 81.5%

Table 4.7 Active Borrowers

GENDER	FREQUENCY	PERCENTAGE
WOMEN	44	81.5
MALE	10	18.5
TOTAL	54	100.0

4.3.2 Benefits of loan portfolio

The benefits of Loans portfolio is one of the determinants of financial performance of microfinance institutions. The respondents were requested to investigate the effects of loan portfolio on the performance of micro finance community based organization using the 4-point Likert scale. The questionnaire comprised 5 options which the respondents were required to rate the options for Purposes of Loan portfolio were captioned as in the table 4.8 below.

Table 4.8 Purposes of loan Portfolio

PURPOSES OF LOAN PORTFOLIO	N	MEAN	STD. DEVIATION
PRUDENTLY ALLOCATION OF LOAN ENHANCE PERFORMANCE OF MFIS	54	1.13	0.339
EFFECTIVE LOAN PORTFOLIO MANAGEMENT MAXIMIZES THE LENDING OPPORTUNITIES	54	1.89	0.317
GROUP LENDING IS AN EFFECTIVE LOAN PORTFOLIO MANAGEMENT	54	1.75	0.442
LOSS OF INCOME GENERATING OPPORTUNITY, DECREASE PERFORMANCE	54	1.00	0.000
DIVERSIFICATION OF LOAN PORTFOLIO INMPROVE PERFORMANCE	54	1.87	0.339
VALID N (LISTWISE)	54	1.528	

From Table 4.8 the results obtained from the survey on the respondents level of agreement on the effects of loan portfolio on the performance of micro finance community based organization show that the average mean response was 1.528 which implies a level of agreement given the scale range from 4 to 1, 4 being

strongly Agree while 1 being too low. Table 4.7 indicates that loss of income generating negatively affects performance of MFIs while prudent allocation of loans Group lending, effective loan portfolio management and diversification of loan portfolio enhances the performance of MFIs.

4.4 Dividend policy

4.4.1 Types of Dividend

The researchers sought to determine the types of dividend policies which have effect on the performance of MFIS.

Table 4.9 Type of dividend policies

DIVIDEND POLICIES	FREQUENCY	PERCENTAGE
REGULAR	10	18.5
STABLE	5	9.3
IRREGULAR	4	7.4
NO DIVIDEND	35	64.8
TOTAL	54	100.0

Table 4.9 indicate that the MFIs do not pay dividends to the shareholders who own and operate the institution through the electing the Board of Directors and committees but rather decide on reinvesting the profits. The savings are mobilized for lending back to the community for productive investments. Hence there was no direct relationship between the dividend policy and performance of MFIs. The role of microfinance institutions was poverty reduction and wellbeing improvement of the people who could not access financial service from commercial banks.

The respondents who agreed to No Dividend policy for MFIs were a majority at 65 %, followed by regular dividend policy at 19 % followed by stable dividend policy at 9% while the least, 7 % irregular policy. With a No - dividend policy, it indicated that the MFIs were mainly concerned with reinvesting the profits rather than payment of dividends to the members. Figure 4.3 below implies that majority of MFIs in within the Kenyan Coast have not been paying dividends but rather reinvesting the profit to smoothen operations .

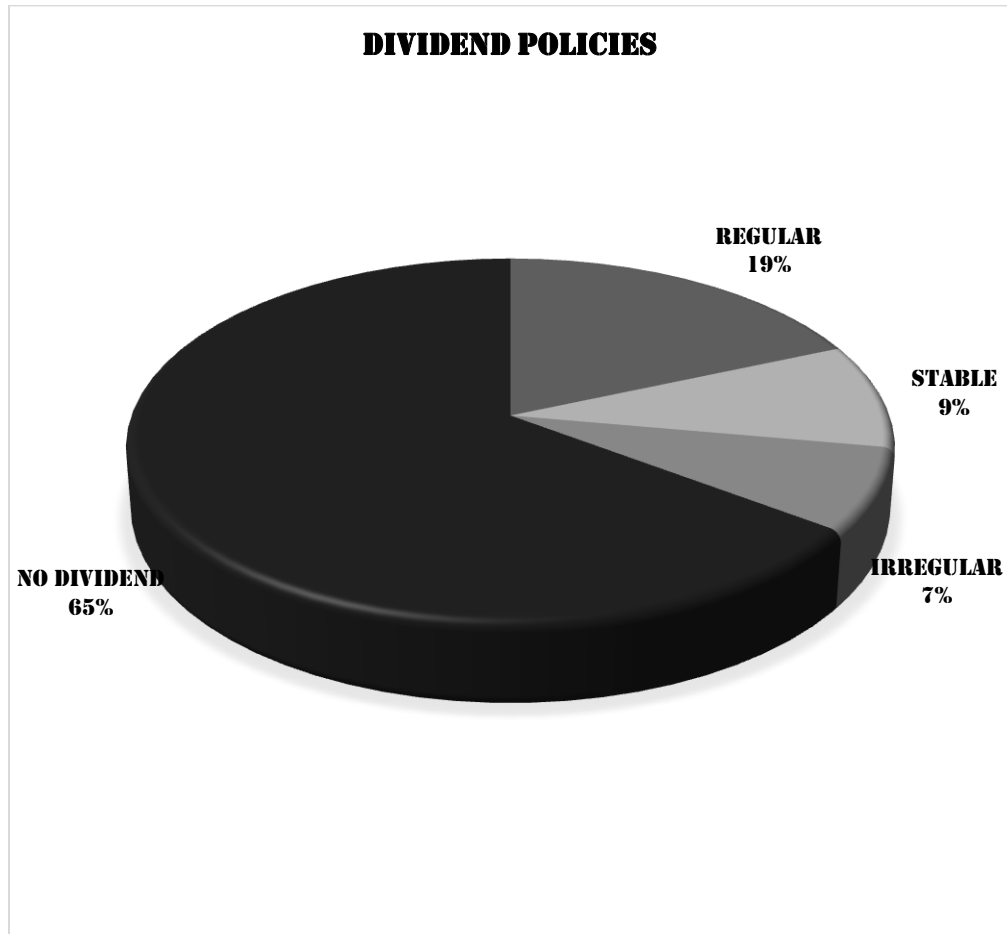


Figure 4.3: Types of Dividend Policies

4.4.2 Benefits of Dividend Policy

Table 4.10 Benefits of Dividend Policy

BENEFITS OF DIVIDEND POLICY	N	MEAN	STD. DEVIATION
THE DIVIDEND DISTRIBUTED TO THE SHAREHOLDERS MAXIMIZE THEIR WEALTH	54	2.63	1.418
THE AMOUNT OF DIVIDENDS DISTRIBUTED TO SHAREHOLDERS AFFECTS THE PERFORMANCE OF MFIS	54	2.30	0.861
THE SIZE OF MFI HAS RELATIONSHIP WITH THE DIVIDEND PAYOUT	54	2.41	0.687
SHAREHOLDERS ARE ENTITLED TO DIVIDEND ONLY WHEN THE EARNING AND LIQUIDITY POSITIONS OF THE MFI WARRANT IT	54	2.39	0.712
VALID N (LISTWISE)	54	2.032	

Table 4.10 indicates that dividends distributed to shareholders could maximize their wealth and hence affecting the performance of MFIs. The size of the firm also determines the dividend payout and shareholders are entitled to dividend only

when the earning and liquidity positions of the MFI warrant it. To ensure the MFIs meets their capital adequacy requirement, Shareholders had forgone dividends, made an additional equity investment, to support MFI operation.

CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter discusses summary of findings in relations to the research objectives. It also draws the conclusions, recommendations and suggested areas for further study.

5.2 Summary of Findings

The research study sought to evaluate the financial determinants on micro finance performance in Kenyan coast, specifically the study explored the research objectives provided in chapter one. This revolved around the financial determinants of MFIs performance including savings portfolio, loan portfolio and dividend policy.

5.2.1 Savings portfolio

It was established that microfinance institutions mainly encouraged members to save in order to get loans. From the study Lower cost source of funds and Savings accumulation did not sufficiently meet the needs of the savings portfolio. Saving services were found to be a valuable mechanism for liquidity management. This meant that most Savings accumulation had a strong market-demand for microfinance institutions. Both voluntary and mandatory savings are the types employed by the MFIs. Insurance savings has not been used by the MFI.MFIs are efficient in terms of savings mobilization. MFIs had introduced insurance savings

as in other parts of the world. Insurance savings could have ensured security to all the members.

5.2.2 Loans portfolio

Prudent allocation of loans, group lending, effective loan portfolio management and diversification of loan portfolio enhanced the performance of MFIs. The different types of loans offered by the MFIs ensured diversification. This led to maximization of returns and risks minimization. Group lending ensured security of loans as repayment of these loan involved all members in a group. One important feature of group- based lending was the use of peer pressure as a "collateral" substitute. Peer pressure from other group members was an effective repayment incentive.

The MFIs had a successful lending program that revolved on funds and loan repayments made to them by the member. Short-term loans had a lower defaulting rate. Long-term loans lead to lead to repayment problems, dissatisfaction and high drop-out rates. The active borrowers were mainly women who achieved multiple productive activities and diversified their sources of income more than men. Loss of income generating negatively affected performance of MFIs.

5.2.3 Dividend Policy

The savings mobilized were used for lending back to the community for productive investments. MFIs did not pay dividends to the shareholders but rather decided on reinvesting the profits. The role of microfinance institutions was

poverty reduction and wellbeing improvement of the people who could not access financial service from commercial banks. Distribution of dividends to shareholders led to maximization of their wealth. Shareholders were entitled to dividend only when the earning and liquidity positions of the MFIs warrant it. Shareholders had forgone dividends to ensure the MFIs meets their capital adequacy requirement.

5.3 Discussion

The research found a strong positive relationship between the performances of MFIs and loan portfolio which was measured by the short, medium and long-term loans. Savings portfolio measured by the purpose of savings, types of saving and savings mobilization had a positive relationship with the performance of MFIs. The findings implied that loan and saving portfolio management have a positive effect on performance of MFIs, although that effect of saving portfolio is not significant. The result showed that Portfolio quality, represented by Portfolio at risk (PAR) >30, had a significant impact on financial performance as measured by the ROE and ROA constituted the main financial performance determinant.

MFIs had not yet developed the dividend policy to encourage members to save more. The size of the firms also determined the dividend payout .MFIs shareholder were mainly concerned with capital adequacy requirement rather than dividend policy. There was a negative relationship between dividend policy and performance of MFIs.

5.4 Recommendations

The study has strongly confirmed that the financial determinants of MFIs strongly related to the efficient management of loan portfolio and savings portfolio components whereby the shareholders' value can be enhanced.

MFIs shareholders should ensure that different innovative mode of savings is introduced, such as insurance savings. This will ensure accumulation of savings to support operations. MFIs should also seek for further financing in order to inject more funds. Saving mobilization which is a lower cost of capital should be encouraged as this will enable the MFIs to be more profitable. The study also recommends that microfinance institutions should open many branches so that they can be able to reach as many as possible which will enhance their sustainability.

MFIs should also apply efficient and effective credit risk management that will ensure that loans are matched with ability to repay, loan defaults are projected accordingly and relevant measures taken to minimize the same. MFIs should also enhance periodic credit risk monitoring of their loan portfolio to increase the loan performance. This can be achieved by hiring qualified debt collectors and competent personnel. It is recommended that management should organize regular trainings in areas like credit management, risk management and financial analysis. This would sharpen the knowledge and skills of credit officers so as to improve on the quality of credit appraisals.

The study recommends for the MFIs to adopt dividend policy as this will ensure that MFIs are able to compete with other business. Adopting a dividend will enable members to save more and hence improving the performance of MFIs. Management committee should be aware of the intermediating impact of future performance and profitability of MFIs. The management should be aware that the imminent competitive pressures affecting MFIs can be appeased through improving adopting dividend policy.

MFIs should seek for Government intervention through the support from youth and women funds, this will help in achieving financial self-sustainability. MFIs to implement modern technologies especially communication technology as this will reduce the transaction cost and increase outreach. Further research to the subject in order to improve on quality management and rendering of MFIs services.

5.5 Further Research

This study has set a foundation for other related research. This study based performance on financial determinants metrics although non-financial parameters have shown to be better performance measures in the service sector hence a study can be carried out that factors that.

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APPENDICES

Appendix A: Letter to Respondents

Dear Sir/Madam,

RE: RESEARCH QUESTIONNAIRE

I am a student at the Technical University of Mombasa pursuing a Master's in Business Administration (finance option). I am kindly inviting you to participate in my academic research project that I am conducting as part of the requirement for the award of the degree. Your participation will involve responding to the questionnaire enclosed to your best of knowledge.

The purpose of this research is to understand the financial determinants on Microfinance institutions in Kenyan coast. The findings of this research will provide some important recommendations that will help the MFIs to enhance their performance.

The information you provide and that may identify you or your organization will be kept strictly confidential.

Your cooperation will be highly appreciated.

Yours sincerely,

Researcher

APPENDIX B: QUESTIONNAIRE

The questionnaire is designed to collect data on financial determinants on micro finance performance in Kenyan Coast. Please provide information that is truthful and as accurate as possible. Your responses will be treated with utmost confidentiality. Fill in blank spaces provided or tick appropriately. Thank you for your cooperation.

SECTION A

Background Information

1. What is your gender? Male Female
2. What is your age bracket? Tick the appropriate.
18-25 years 26-35 years
36-45 years 46-55 years
Over 55 years
3. What is your Level of Education? Tick the appropriate.
PHD Masters Bachelors
Diploma Certificate
4. Which MFI are you working with? NANIMO JUMBE
5. How long have you worked in this institution? Tick the appropriate.
Less than 1 year 2-5 years 5-10 years
6. In which capacity are you engaged with in the MFI?

Board of Directors Management Committee
 Credit Committee members CBOs representatives Staff

Section B: Savings Portfolio

7. What type of savings does MFI offer to the clients?

Voluntary savings Mandatory savings

Insurance savings

8. How many clients have been saving with the MFI and what are the annual savings for a period of 5 years?

Type of Savings year	Voluntary savings		Mandatory savings		Insurance savings	
	Number of Savers	Annual Savings	Number of Savers	Annual Savings	Number of Savers	Annual Savings
2011						
2012						
2013						
2014						
2015						

9. Indicate the approximate total monthly savings from clients.

Approx. monthly Savings	Number of Savers
Below 500	

501-1000	
1001-2000	
2001-3000	
Over 3000	

10. Indicate the gender of savors from CBOs and Individuals

Women Male

11. Below are some benefits of MFIs savings, please let us know your opinion.

Use a scale of 1 to 4 where, 1 = Strongly agree, 2 = Agree, 3 = No opinion, 4 = Disagree

Benefits of savings	1	2	3	4
liquidity management				
Lower cost source of funds				
source of capital				
create strong market demand				
important tool to generate business growth				

Section C: Loan portfolio

12. Indicate the number of active borrowers with the MFIs

Women Male

13. What are the types of loans issued by the MFI?

Short-term Loans [] Medium-term Loans [] Long-term Loans []

14. What is the size of the loan as per type and repayment period?

Type of Loan	Amount	Repayment Period
Short-term	Below Kshs 50000	12 months
Medium-term	Kshs 50,000-100,000	24months
Long-term	100,001 and above	36months

15. Below are some purposes of MFIs Loans, please let us know your opinion. Use a scale of 1 to 4 where, 1 = Strongly agree, 2 = Agree, 3 = No opinion, 4 = Disagree

Benefits of MFI Loans	1	2	3	4
prudently allocation of loans and monitoring loan enhance performance of MFIs				
effective loan portfolio management maximizes the lending opportunities				
group lending is an effective loan portfolio management				
loss of income generating opportunity will lead to reduction in loan portfolio				
Diversification of loan portfolio enhances performance of MFIs				

Section D: Dividend policy

16. What type of dividend policy is implemented in the MFI

Regular Dividend Policy Stable Dividend Policy

Irregular Dividend Policy No Dividend Policy

17. Below are some benefits of Dividend policy to the operation of MFIs, please let us know your opinion. . Use a scale of 1 to 4 where, 1 = Strongly agree, 2 = Agree, 3 = No opinion, 4 = Disagree

Benefits of MFI Dividends	1	2	3	4
Distributed dividends maximize shareholders wealth				
The size of MFI has relationship with the dividend payout				
shareholders are entitled to dividend when the earning and liquidity positions warrant it				
dividend policy affects performance of MFIs				

Section E: Financial Performance

18. 38. Please provide **an estimate** of the following financial details

Financial Item	31.12.2014	31.12.2013
	KSHS	KSHS
Total Assets		
Total Liabilities		
Shareholders' Funds		
Net profit		