FACTORS INFLUENCING THE SUSTAINABILITY OF MICROFINANCE INSTITUTIONS IN MURANG'A TOWN, KENYA

by

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Profile

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Ruth holds MSc (Entrepreneurship) from Kenyatta University and BSc (Entrepreneurship) from Karatina University. Her theses revolved around microfinance institutions and microenterprises in Kenya. Ruth also holds the following diplomas: Higher National Diploma in Entrepreneurship Education and Diploma in Technical Education from Kenya Technical Teachers College and Diploma in Institutional Management from Technical University of Kenya (Formerly known as Kenya Polytechnic).

Previously, Ruth served as the chair of Institutional Management Department at Murang'a College of Technology (MCT) for fifteen years where she received honours on numerous occasions for achieving commendable results in national Exams. Ruth consistently achieved 100% student pass rate in externally assessed Trade and Entrepreneurship projects.

As an internal Quality Auditor, Ruth steered MCT through the entire roadmap of ISO 9001:2008 certification and received a commendation for her sterling performance. She was able to audit and evaluate all process and enhance implementation of the Quality Management Systems.

At MUT, Ruth sits in the following academic and non-academic committees: Research and Development committee, Work-Study Committee, Benevolent Fund Committee and Tender Opening Committee. The university also appointed her as the inaugural patron of the students' Christian Union. Ruth has received accolades for extemporal performance during Entrepreneurship Skills workshops for SMEs and Murang'a County Government officials.

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(Murang'a University of Technology is the Successor of Murang'a University College, a former constituent College of Jomo Kenyatta University of Agriculture and Technology (JKUAT), and Murang'a College of Technology based in Murang’a County, Kenya)

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DECLARATION

This research project is my original work.

Ruth Wanjiku Muriithi

TABLE OF CONTENTS

LIST OF TABLES

LIST OF FIGURES

ACRONYMS

MFI –Microfinance Institutions

MPCM –Multi-Purpose Cooperative Microfinance

NGO –Non-Governmental Organization

SACCO –Savings and Credit Cooperative Society

ICEG – International Conference on E-Governance

ABSTRACT

Providing the poor with access to savings and credit services as a poverty alleviation strategy has gained prominence in the past ten years. This has resulted from the emergence of models that have shown increasing success in terms of their ability to reach the poor and in sustaining the delivery of financial services. However, a significant number of those engaged in microfinance services continue to struggle with the twin goals of outreach and sustainability (Tang 2002).

This study therefore sought to establish the factors affecting sustainability of microfinance institutions operating within the Murang'a Town. The aim of the study was to gain a better understanding of the factors, which are critical to their sustainability. Specifically, the study aimed at establishing various factors influencing sustainability of microfinance institutions within the Town.

The methodology employed involved a descriptive design study seeking to explore the situation of microfinance institutions in the Town. The study used questionnaires to collect data from 45 respondents who consisted of 15 managers and 30 field personnel's the microfinance institutions that operate within Murang'a Town. The data obtained was analyzed using descriptive statistics.

From the study, the researcher found that financial regulations, number of clients served, financial coverage and volume of credit transacted were the factors that highly affected the sustainability of microfinance institutions.

The study concludes that sustainability of MFIs is a function of many factors that are related and interconnected i.e. low level of client base affect the sustainability of MFIs. Similarly, the limited branch network leads to low sustainability. Also lending to individual client contributes to higher repayment rate. The researcher also concluded that mandatory saving is a sector to MFIs sustainability. The study also concludes that sustainability of MFIs is a motive that MFIs continuously work to achieve. The study recommends that microfinance institutions should open many branches so that they can be able to reach as many people as possible which will enhance their sustainability and also for them to

survive well in the market they should ensure that they conform to the rules and regulations regarding registration, adherence to the government policies.

CHAPTER ONE: INTRODUCTION

1.1: Background

Microfinance has become an important tool for poverty reduction in many parts of the world. Microfinance institutions (MFIs) target the poor through innovative approaches which include group lending, progressive lending, regular repayment schedules, and collateral substitutes.

From bankers' perspective, a microfinance institution is said to have reached sustainability when the operating income from the loan is sufficient to cover all the operating costs (Sharma and Nepal, 1997). This definition adopts the bankers' perspective and sticks to 'accounting approach' of sustainability. However, Shah (1999) adopts for an 'integrated approach' in defining the term sustainability as the 'accounting approach' to sustainability that takes into account the financial aspect of the institution is too narrow for him. For Shah, the concept of sustainability includes, amongst other criteria, - obtaining funds at market rate and mobilization of local resources. Therefore, his performance assessment criteria for the financial viability of any microfinance related financial institution are: repayment rate, operating cost ratio, market interest rates, portfolio quality, and 'demand driven' rural credit system in which farmers themselves demand the loans for their project. From banker's perspective, sustainability of microfinance institution includes both financial viability and institutional sustainability (self sufficiency) of the lending institution (Sharma and Nepal, 1997).

In a stable political environment and enabling macro economy, evidence arising over several decades has supported the view that the provision of microfinance is an important component of any effort to improve the livelihoods of the poor in any society. In recent years in Kenya, there has been renewed interest in microfinance by both policymakers and practitioners. This interest is based on its valued contribution to efforts aimed at improving the livelihoods of the rural population in Kenya through policies and programs geared towards addressing inequalities arising from the country's socio-political history. Microfinance refers to all types of financial intermediation services; savings, credit funds transfer, insurance, pension remittances, provided to low-income households and enterprises in both urban and rural areas, including employees in the public and private sectors and the self-employed (Robinson, 2002).

In microfinance, sustainability can be considered at several levels institutional, group, and individual and can relate to organizational, managerial, and financial aspects (Rao, 2001). However, the issue of financial sustainability of microfinance institutions has attracted more attention in mainstream analysis at the expense of the sustainability of the client/borrower. MFIs face an apparent tension between achieving financial sustainability and contributing to poverty reduction.

Various researchers have argued that in democratic societies, small scale entrepreneurs have a right to a participatory role and full ownership of microfinance organizations including planning, management, and decision-making (Weitz, 1982). The basis of the argument is that the entrepreneurs have access to local knowledge, which is unknown to official experts. The supporters of this school of thought have argued that microfinance institutions should not be run by public sector organizations; it should rather be handed over to small farmers in order to generate a sense of ownership among small farmers (Sharma and Nepal, 1997) and to attain institutional sustainability of microfinance institutions (MFIs).

1.2: Statement of the Problem

The performance of microfinance institutions in terms of institutional sustainability seems not encouraging despite the fact that international and national development programs have been giving high priority on sustainable microfinance for poor for many years. In response to low repayment rate and the question of sustainability of microfinance schemes, many proposals have been forwarded for initiating small farmers' development program and encouraged their participation in sustainable microfinance institutions (Weitz, 1982; Wehnert and Shakya,2003).

The delivery of financial services to the poor and low-income people has changed significantly over the recent past. The long-standing assumptions that the poor cannot be good clients of the financial institutions have been challenged by well-documented experiences (Yunus, 1996). A number of micro finance programs have demonstrated that low-income clients can use small loans productively and are willing to pay higher rates of interest for their loans. It has also been proved that the poor need saving services as much or more than credit services (Webster and McGrath, 1996).

Sustainability which refers to the ability of a microfinance institution (MFI) to cover all of its costs through interest and other income paid by its clients is a cornerstone of sound microfinance. Financially sustainable MFIs can become a permanent part of the financial system and can continue to operate even after grants or soft loans are no longer available.

The growth of MFIs can be attributed to factors such as their contributions to social welfare, job creation and general economic and improvement of lives of the poor. However, despite the interest in the sector and the subsidies that have flowed into some of the mission-oriented MFIs, it appears challenging to make an MFI viable over the long term. One survey found that 30 percent of domestic microfinance programs operating in 2001 were either no longer in operation or were no longer lending capital two years later (Bhatt, Painter, and Tang 2002). Furthermore, most microfinance programs report difficulty in sustaining its operations without continued reliance on grants, external fundraising, or other subsidies.

Locally, a few studies have been done on the issue of sustainability which included; sustainability of pilot purpose community telecentres in Kenya and Uganda (Munyua, 2003), sustainability strategies adopted by KARI (Gicobi, 2006) and sustainability among non profit organizations in Kenya (Njoya, 2004). To the researcher’s understanding, no study has been carried out on the factors of sustainability of microfinance institutions. This study therefore seeks to answer the question, what are the factors influencing sustainability of microfinance institutions and specifically in Murang’a Town?

1.3: Objectives of the Study

1.3.1: General objective

The main objective of this study was to establish the factors affecting sustainability of microfinance institutions in Murang’a Town.

1.3.2: Specific Objectives

1. To identify whether financial regulations in the country influence sustainability of microfinance institutions

2. To establish whether the volume of credit given to clients influence the sustainability of microfinance institutions

3. To find out whether the geographical coverage and reach of the microfinance institutions in Murang’a Town influence their sustainability

4. To investigate whether the number of customers served influence the sustainability of microfinance institutions

1.4: Research Questions

The study sought to address the following research questions

1. What are the financial regulation factors in the country that influence

sustainability of microfinance institutions?

2. How does the volume of credit given to clients influence the sustainability of microfinance institutions?
3. How does the geographical coverage and reach of the microfinance institutions in Murang'a Town influence their sustainability?
4. What is the effect the number of customers served on the sustainability of microfinance institutions?

1.5: Significance

The study is important to the following groups:

Regulators and Practitioners

By focusing on achieving institutional, financial sustainability; regulators and practitioners of microfinance in Kenya, the study will contribute towards domestic institution building for financial capacity widening and deepening in locally constituted organizations and funds.

Microenterprises

The owners of the enterprises will be able to know their contribution towards the success and sustainability of the microfinance institutions, which are important to their operations. Eventually, they will take up their ultimate role in supporting the performance of the institutions.

Society

Majority of Kenyan population are poor and hence depend on MFIs as source of capital and general finance. Since the study seeks to establish factors of sustainability of MFIs, the study would prove invaluable to them indirectly, though, for it would help further MFI sustainability which is a source for finance to them.

Researchers

The study will provide a source of reference for future studies on microfinance institutions. It will also act as a source of literature for academics in the field of entrepreneurship.

1.6: Scope of the Study

This study covered all the microfinance institutions operating within Murang'a Town. Since the study intended to carry out a survey of the microfinance institutions, data was collected to predict various effects of the variables identified by in ensuring the sustainability of various microfinance institutions within the Town.

1.7: Definition of terms

Microfinance - refers to all types of financial intermediation services; savings, credit funds transfer, insurance, pension remittances, provided to low-income households and enterprises in both urban and rural areas, including employees in the public and private sectors and the self-employed.

Microfinance institution – refers to an organisation that offers financial services to the very poor. They are also specialised providers of financial services to the microenterprises.

Sustainability – Refers to the ability to continue any given activity into the future within the likely existing resources of an organization, as part of its ongoing budgetary and management processes.

Micro Enterprise – refers to a privately owned firm of small capital and a few number of employees usually not more than 50.

Volume of Credit – is the amount of advances/loans/financial assistance that an MFI gives to its targeted clients.

1.8: Limitations of the Study

There were four limitations of the study. The first limitation involves the issue of confidentiality. Some of the institutions were not willing to reveal information about their organization fearing that it would be used by their competitors. This was overcome by sending the questionnaires together with the introductory letters with specific information on the purpose of the research and the confidentiality of information provided. The letter detailed the fact that the information was used specifically for academic purposes.

The second limitation involved finance. All the expenses involving the research were being met by the researcher. The researcher overcame this by acquiring loans so as to meet the expenses.

The third limitation was time. The researcher had other responsibilities in her working place and had to struggle to see that the research was finished in good time.

The last limitation facing the study emanated from the bias of the respondents as well as self reports.

CHAPTER TWO: LITERATURE REVIEW

2.1: Introduction

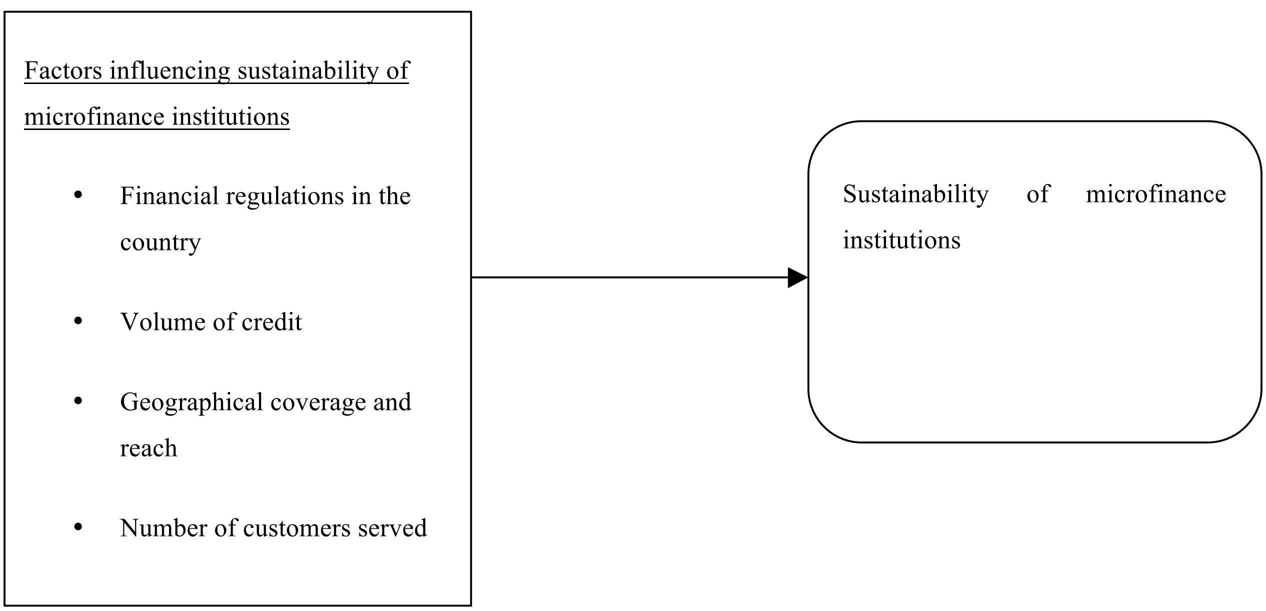
This chapter presents review of literature on various factors that influence the sustainability of microfinance institutions. The literature explored discusses various factors that can influence the sustainability of these institutions. They include factors such as the financial regulations in the country, volume of credit, geographical coverage and number of customers served.

2.2: Conceptual Framework

From the foregoing discussion of the factors affecting sustainability of MFIs, the following is a representation of the variables of interest in a conceptual framework.

Figure 2.1: Conceptual Framework

Independent Variables **Dependent Variable**



Source: researcher (2013)

A conceptual framework is a model that presents and explains the relationship between various variables. In a conceptual framework there are three types of variables: dependent, independent and intervening variables. In this study, as conceptualized by the author (2013), the independent variables are the financial regulations imposed on the MFIs, Arsyad (2005) noted that bad regulation can stifle an MFI to the point of rendering it out of business while good regulations enhance its sustainability. Volume of credit transacted by the MFIs, volume of credit traded financial coverage and number of customers served. Volume of credit traded either enhances or negates MFIs sustainability with its increase or decrease respectively Geographical coverage and numbers of customers served by individual MFIs. The independent variables influence sustainability of the MFIs which in this study is the dependent variable.

The variable highlighted above can be grouped into internal and external aspects or factors. The internal factors affecting sustainability of the MFIs include management. Arsyad (2005), noted that financial regulation astringent rules stifle an MFI growth while a liberal regulation promotes its growth. External factors affecting MFIs can be categorized into financial regulation.

The variables highlighted above can be affected by the intervening variables, which are both internal, and external i.e. political scenario will either assist in the promotion or destroying the MFIs

Internal factors like the MFI management, Technology used to transact business, skills of the staff will also intervene and influence on the sustainability of the MFI.

2.3: Sustainability of Microfinance Institutions

Sustainability is a cornerstone of sound microfinance. This term refers to the ability of a microfinance institution (MFI) to cover all of its costs through interest and other income paid by its clients. Financially sustainable MFIs can become a permanent part of the financial system: they can continue to operate even after grants or soft loans are no longer available. Donors have nowhere near enough funds to meet the global demand for microfinance. But when an MFI becomes sustainable, it is no longer limited to donor funding. It can draw on commercial funding sources to finance massive expansion of its outreach to poor people. Experience proves that microfinance can be done sustainable, even with very poor clients.

From bankers' perspective, a microfinance institution is said to have reached sustainability when the operating income from the loan is sufficient to cover all the operating costs (Sharma and Nepal, 1997). This definition adopts the bankers' perspective and sticks to 'accounting approach' of sustainability. However, Shah (1999) adopts an 'integrated approach' in defining the term sustainability as the 'accounting approach' to sustainability that takes into account the financial aspect of the institution is too narrow. He states that the concept of sustainability includes, amongst other criteria, - obtaining funds at market rate and mobilization of local resources.

Therefore, the performance assessment criteria for the financial viability of any microfinance related financial institution are: repayment rate, operating cost ratio, market interest rates, portfolio quality, and 'demand driven' rural credit system in which farmers themselves demand the loans for their project. From banker's perspective, sustainability of microfinance institution includes both financial viability and institutional sustainability (self sufficiency) of the lending institution (Sharma and Nepal, 1997). The frames of reference in banker's definitions are therefore, more financial, administrative and institution focused.

2.3.1: Financial Regulations

Arsyad (2005) carried assessed the performance and sustainability of MFIs in Indonesia. Using a case study on village credit institutions, he found out that rowing economy and supporting government policy at all levels through provision of a legal basis for the MFI and the Central Bank regulation (formal institutions) had contributed to the success of the MFIs. Thus, based on the necessary conditions of sustainable microfinance institution proposed by some scholars (Yaron 1994; Christen 1998), he concluded that the Gianyar district village credit institutions (*Lembaga Perkreditan Desa* or LPD) have been sustainable, and by that implication they had positive net social benefits for their clients.

It costs much more to make a thousand $200 loans than to make one $200,000 loan. To be sustainable, MFIs must charge high interest rates. Clients willingly pay these rates because they value the service so highly. When governments enforce interest rate caps, MFIs can't charge enough to be sustainable. Regulation helps in long term sustainability, even though MFIs may chafe under it in the initial years. Regulation and supervision ensure that MFIs are run prudently and cases of poor people losing their money due to fraud or incompetence are minimised. At present, most Indian MFIs are NGOs, and thus not treated as part of the mainstream financial sector. Various actions and announcements by governments are indicative of the acceptance and recognition of the role of NGO-MFIs as part of the microfinance sector. There is also restriction on the usage, volume of credit and channel of lending.

The need for regulation is often motivated by the different objectives of those involved. Some MFIs need more funds to lend out through their micro credit operations. They would want to be regulated in order to be allowed to offer bank accounts to hold their savings. Some other NGOs believe that regulation will promote their business and improve their operations. Others want to be licensed in order to expand the range of services they can provide to the poor.

In Kenya, the Microfinance Act which became operational in May, 2008 addresses licensing provisions, minimum capital requirements and minimum liquid assets, submission of accounts to the Central Bank, supervision by the Central Bank, and limits on loan and credit facilities. It also seeks to protect depositors by requiring that deposit-taking MFIs contribute to the deposit protection fund. The reasons for so few applications have not been publicly stated and there does not appear any element of the Act that is glaringly prohibitive, although there may be more obvious operational challenges on the ground, such as the minimum capital requirement of KSH 60 million (USD 793 thousand) which must be maintained by deposit-taking MFIs at all times. There does not seem to have been an investigation into possible reasons that MFIs have not registered, although a study by the United Nations Capital Development Fund (UNCDF) in 2003 predicted that it would not be easy for MFIs to meet the supervision standards of the Act as it stood at that date.

The Association of Microfinance Institutions of Kenya (AMFI) is a member Institution and trade association established in 1999 under the societies Act by leading Microfinance Institutions in Kenya. It was originally funded by USAID, but it is unclear whether this funding continued after the initial three-year period. Its purpose is to build capacity of the microfinance industry in Kenya. AMFI presently has 36 member institutions which provide financial services to more than 2,000,000 low to middle income families throughout Kenya (Curtis. 2008).

2.3.2: Number of Customers Served

The benefit that microfinance provides to low-income households and micro enterprises has positive implications for the overall economy. Firstly, the provision of savings facilities deepens financial markets by mobilizing savings that were not previously part of the money supply. In addition to the savings that are stored by low-income households and microenterprises in informal markets, some cases exist where microfinance institutions attract the finances of informal money lenders into the formal financial sector (Chaves, and Gonzales-Vega, 1994).

This increase in gross savings creates a larger pool of resources that can be channeled to gross domestic investment opportunities, which has positive implications for economic growth? Secondly, the increase in savings flowing into microfinance institutions increases the amount of credit available. This can lower the cost of loans relative to those offered by informal moneylenders. The benefit of this credit in reducing vulnerability in low income households and microenterprises increases productivity and income (Chaves, and Gonzales-Vega, 1994).

This reduces income inequalities in an economy, which has positive implications for human development initiatives. Pitt and Khandker (1996), stated that incomes of those admitted to a microfinance program rise to the level of those who were in higher income households by its design. Microfinance is instrumental in promoting the sustainability of micro enterprises, to the extent that it creates an improvement in the management of their financial activities. This should lead to the strengthening of the domestic production structure, which has positive implications for balanced development across different sectors and regions (ICEG, 1999).

The microfinance industry is evolving as a result of the increasing number of credit providers and market experience using micro finance products. As a result, developing customer retention strategies has become a priority for microfinance institutions (MFIs). Some MFIs emphasize improving customer service as a way to gain a competitive advantage yet this does not necessarily diminish attrition. A comprehensive understanding of the customer and an analysis of the reasons for leaving an institution is required to develop an effective retention strategy.

While the market evolves, retention becomes a key component in the strategy of an MFI. Retention is important not only because retaining customers’ costs less than acquiring new ones or because customers need to remain in the MFI until they become profitable. Rather, customer retention is important because it is a value generation strategy: guaranteeing future revenues greatly depends on strengthening its customers' loyalty. For this reason, two MFIs with the same number of customers, profitability, delinquency rates and others factors, can have different institutional value if one of them has more loyal customers.

As such, customer retention is not only necessary for the sustainability of a MFI but it is also a value generation strategy for its shareholders and stake holders.

2.3.3: Financial and Geographical Coverage and Reach

The ultimate goal of all poverty alleviation efforts is to improve livelihoods. There are many instruments used to achieve this. The microfinance instrument advocates two main ways i.e. the financial systems approach and the poverty lending approach. These two approaches complement each other to improve access to financial services based on self-help, community-based groups that also provide a forum that enables interaction for social purposes (Holt, 1994). These mutual support groups form a basis for building local capacity to manage microfinance institutions in a participatory manner with the hopes of inspiring similar target groups in other areas.

The financial systems approach aims to achieve maximum outreach of microfinance services through financially sustainable institutions that focus on a financial intermediation model (Robinson, 2002). The microfinance institutions under this approach provide finance to the public e.g. commercial banks; or serve only their members such as village banks. They finance their loan portfolios from locally mobilized savings, commercial debt and for-profit investment, or retained earnings such as micro lenders.

Microfinance institutions under this approach are differentiated from informal money lenders, from unregulated institutions such as NGOs and from subsidized formal micro credit – where a regulated institution such as a state-owned bank channels government or donor funds to borrowers at subsidized interest rates (Robinson, 2003). The proponents of the financial systems approach argue that donors and governments should shift the allocation of their scarce resources from direct financing of loan portfolios, to promoting the replication of this model by disseminating lessons from the best practices of fully sustainable microfinance institutions and financing the development of more microfinance institutions of this type. One challenge of the financial systems approach is that it relies on market approaches, which may be thin and weak in marginal areas (Pralahad, 2004). However, even in these areas, market solutions can be found to overcome any obstacles (Hitchins, Elliot & Gibson, 2005).

The model of microfinance provision that is most suitable for the financial systems approach is the village bank. These institutions are involved solely in the provision of microfinance and do not provide non-financial services. They include community-managed savings and credit cooperative societies. They typically consist of a general membership of 30 to 50 members based on self-selection, and an elected committee that is responsible for convening meetings, approving loans, supervising loan payments, receiving savings deposits, lending out or investing savings and keeping up-to-date records (Holt, 1994 and North, 1990).

It consists of a sponsoring agency envisioned to require very little administrative overhead that supports several SACCOs through promoters who train and organise them and then lend seed capital to these newly established institutions as for on lending to members who have gone through a trial period. 20% of each disbursed loan is withheld as collateral and to build a fund that is used in the future financing of new loans or collective income-generating. No interest is paid on share savings; instead, members receive a share of profits from the Sacco's re-lending activities or other investments. Where dividends are paid, these are usually low and members have little incentive to save for reasons other than to maintain their loan eligibility. If inflation rates increase microfinance institutions will be forced to substitute mobilized savings and interest bearing deposits for share savings as the primary source of capital, this can result in a gradual improvement in incentive payments for equity.

When members repay their first loan on time they get a second loan. However, when those applying to SACCOs are from better off households, this model can have little impact on improving livelihoods Coleman (2002). To prevent wealthier members from gaining disproportionate access to the village bank's capital, the model is designed to encourage members to work towards building sufficient savings to reach the external account maximum loan limit and then graduate from the program. This model assumes that members will graduate to more formal financial institutions either as individual clients or the bank as a whole. If this does not occur, projects can be modified to establish village banks as independent, sustainable institutions at their existing capacities.

Although the graduation paradigm argues that the services provided by SACCOs may not be attractive enough to attract higher-income households because loan amounts are not large enough and interest rates on savings are not favorable, it has to be noted that in developed countries these institutions are a formidable competitor to commercial banks because their lower operating costs enable them to charge lower fees for customer transactions (Curry, 1999). Over the long-term sponsoring agencies aim to reduce promoter visits and minimize transaction costs by transferring many of the administrative aspects of providing microfinance to the SACCOs, such that they operate independently. This allows the sponsoring agency to set up more SACCOs in other areas. The village banking model is a minimalist microfinance model, no ancillary devices are provided.

However, the microfinance target group may require both financial and non-financial inputs such as health, education, nutritional support in the case of low income households and business training to help develop microenterprises beyond subsistence levels that a minimalist service delivery methodology does not incorporate (Mead, 1994). The poverty lending approach focuses on reaching the poorest of the poor, who are typically engaged in pre-entrepreneurial activities that are more focused on consumption-smoothing than productivity enhancing activities (Honohan, 2004). This group requires assistance in the form of income transfers to meet their basic needs, because any credit extended to them will most probably be consumed rather than invested in something that generates a return sufficient to repay the debt (Rosengard, 2001).

The poverty lending approach differs from the minimalist financial services model characterized by the financial systems approach. In addition to microfinance services, it provides ancillary services such as training on nutrition, better farming techniques, family planning, health and basic financial management skills aimed at reducing the target group's vulnerability to avoidable risk. The funding for these ancillary services is typically provided by governments, donor grants and other subsidized funds. Previously, loan portfolios used to be funded by donors and governments and loan provision was subsidized at below market interest rates.

However, increasing evidence that the microfinance target group repayment rates are not affected by market related interest rates has changed the practice of subsidizing interest rates. In addition, the use of 'forced savings' has reduced the extent to which donors and governments are required to fund loan portfolios, even if the microfinance target group is not able to save, initially.

Practices have been adopted to ensure that the provision of ancillary services that target those in the pre-entrepreneurial group is done without compromising the financial sustainability of the microfinance function of the institution. This is done by making a clear distinction between the funds allocated to services. Member savings are used to fund the former, while government and donors support is used to fund the latter.

2.3.4: Volume of Credit

More than 90% of the volume of credit awarded to agriculture by MFIs consists of short-term loans used for inputs, labour, and fattening. A proportion of the failures observed in these loans is related to their weak diversification, their poor suitability to modes of agricultural production (in terms of calendar, amounts, repayment procedures, etc.), and their 'ragbag' character (they are used for season funding and also for consumption, the bridging time, extra-agricultural activities, etc.). Improving knowledge of agricultural activities, disseminating this in MFIs and applying it to the development of new financial products is therefore an important issue for agricultural credit (Wampfler, 2000).

With the exception of several credit unions, very few MFIs propose medium-term loans (MTLs) for agriculture at a significant scale. There does not seem to be any experience of long-term credit in Africa, where it would nevertheless be needed to finance the renewal of perennial crops (coffee, cocoa, palm, etc.) and the development of arboriculture. Likewise, MFIs provide only very marginal cover of the medium-term loan requirements of farmers' organizations. The few existing, significant experiences have led to encouraging results in the well-mastered framework of cotton chains and may well be called into question with the liberalization of the latter. The testing of 'leasing' in Madagascar has no equivalent in Africa (Wampfler, 2000).

2.4: Critical Review of Major Issues

Most microfinance institutions are started with the target group being the middle and low income level persons, their success therefore depends on the support received form those who operate and benefit form it. Sustainability is achieved when microfinance is able to cater for its routine expenses and meet any debts that arise in the course of its operations. The literature above has considered the model of a micro finance to be very important in ensuring success. Different models attract people with different needs and therefore a specific model should be used when it best fits the desired target group.

In Kenya various researchers have addressed different aspects of microfinance institutions. Wanjiru (2000), studied the factors that influence productivity of credit officers in microfinance institutions. The study established that productivity of the officers depends on the remuneration and other benefits obtained from their job responsibilities. In some institutions the officers were remunerated based on the successful loan management.

James (2007), studied the credit rationing by micro finance and its influence on the operations of the small and micro enterprises. The study established that, credit rationing is a tool used by most micro finance institutions to hedge the effects of default by the borrowers. As a measure, the study established that the institutions require some form of collateral before giving loans. The effects of this rationing based on collateral, the study established, has denied many small and micro enterprises access to the financial services required for growth.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1: Introduction

The chapter looks at the methods that were used in the survey of the factor influencing sustainability in microfinance institution in Murang'a Town. This chapter is structured into research design, population of study, sample, data collection and data analysis.

3.2: Research Design

This study was a descriptive survey. Descriptive survey was preferred for it is used to obtain information concerning the current status of a phenomena and purposes of these methods is to describe "what exists" with respect to situational variables i.e. this helps to explain the relationship between and among variables. This method was successfully used by Wanjiru (2000), in a study of factors that influence productivity of credit officers in microfinance institutions with a lot of success and so the method is perceived to be the best in obtaining in-depth data.

3.3: Population of Study

The population of study comprised of all the managers of the microfinance institutions and all the field officers Murang'a town.

3.4 Sampling procedure and sample size

The population of interest in this study consisted of 45 respondents who included 1 manager of the institution in each of the 15 microfinance institutions in Murang'a

Town and 2 field officers from every institution. This study was limited to the institutions that operate within the Town so as to obtain the relevant data on the subject matter. Simple random sampling was used in the selection of the field officers.

3.4: Data Collection tools and instruments.

This study was facilitated by the use of primary data. Primary data was collected from the managers and the field/operations staff of the institutions using structured questionnaires provided in appendix 1. The questionnaires addressed the objectives of the study.

Secondary data was got from various magazines, newspapers, libraries, prospectus, journals, brochures and any other document released to the researcher during the research.

3.5: Data Analysis

The data obtained from the questionnaires was grouped based on the research questions and analyzed by descriptive statistics such as percentages, mean scores and standard deviations which eventually led to conclusions on the objectives of the study.

CHAPTER FOUR: DATA ANALYSIS AND INTERPRETATION

4.1: Introduction

This chapter presents analysis and findings of the research. From the sample population targets of 45 respondents i.e. 15 institutions managers and 30 field managers, 36 respondents responded and returned the questionnaire, constituting 80% response rate.

4.2: Biographic Data

Table 4.1: Duration the Firm Has Been In Operation in Kenya

	Frequency	Percent
5-10 years	15	41.7
11-15 years	12	33.3
Over 15 years	9	25.0
Total	36	100.0

The study sought to find the duration that the firms had been operating in Kenya. From the study, the majority of the firms had been operating in Kenya for 5-10 years as shown by 41.7% of the respondents, 33.3% of the firms had been operating in Kenya for 11-15 years, while 25% of the firms had been operating in Kenya for over 15years. This information was also shown by the figure below;

Figure 4.2: Duration the Firm Has Been In Operation in Kenya

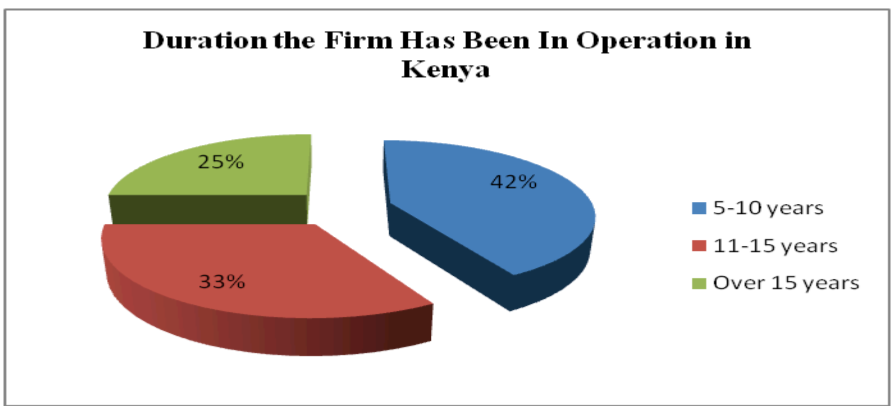
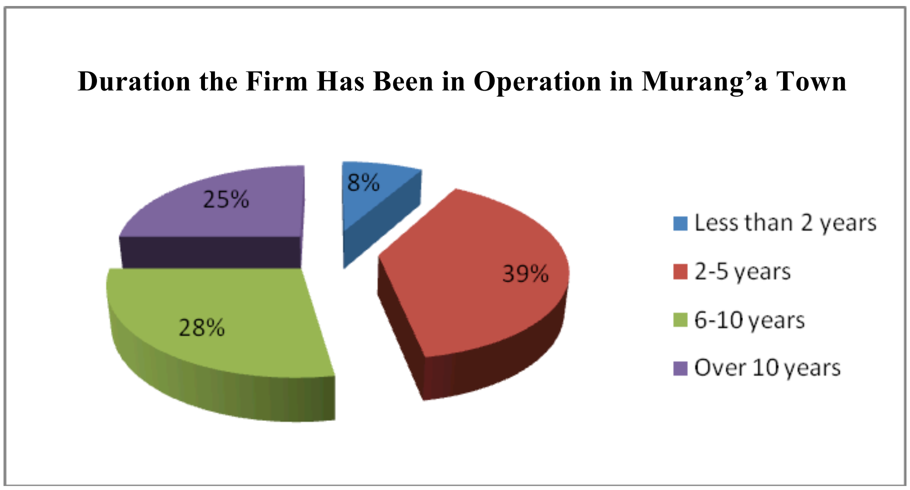


Table 4.2: Duration the Firm Has Been In Operation in Murang'a Town

	Frequency	Percent
Less than 2 years	3	8.3
2-5 years	14	38.9
6-10 years	10	27.8
Over 10 years	9	25.0
Total	36	100.0

The findings in the above table also shows the duration the microfinance institutions had been operating in Murang'a Town. From the study, the majority of these firms as shown by 38.9% of the respondents had been operating in Murang'a Town for 2-5 years, 27% of the firms had been operating in Murang'a Town for 6-10 years, 25% of the firms had been in operation in Murang'a Town for over 10 years, while 8.3% of the firms had been operating in Murang'a Town for less than 2 years. The information in the above table was also shown in the pie chart below.

Figure 4.3: Duration the Firm Has Been In Operation in Murang'a Town



The Institutions Headquarter

From the study, the headquarters of the majority of these microfinance institutions was in Nairobi, while a few others reported that their headquarter was in Murang'a Town.

Table 4.3: Number of Employees the Organizations Have In Murang'a Town

	Frequency	Percent
5-10	6	16.7
11-15	9	25.0
16-25	18	50.0
More than 25	3	8.3
Total	36	100.0

The study also sought to find out the number of employees that the microfinance institutions had in Murang'a Town. From the findings, the majority of the firms had 16-25 employees as shown by 50% of the respondents, 25% of the firms had 11-15 employees, 16.7% of the firms had 5-10 employees, while 8.3% of the firms had more than 25 employees in Murang'a Town. This information is also shown in the figure below.

Figure 4.4: Number of Employees the Organizations Have In Murang'a Town

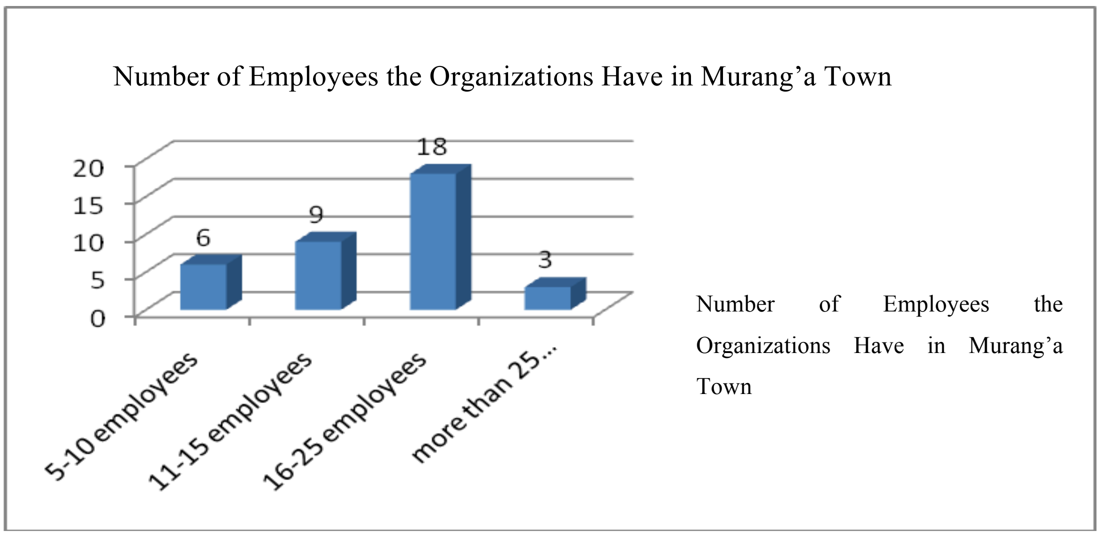


Table 4.4: Mode of Maintaining the Records

	Frequency	Percent
Manually	9	25.0
Use of computers	27	75.0
Total	36	100.0

The findings in the above table show how the records in the microfinance institutions were maintained. From the study, the majority of the firms as shown by 75% of the respondents maintained their records by use of computers, while 25% of the institutions maintained their records manually. The above information was also represented in the figure below.

Figure 4.5: Mode of Maintaining the Records

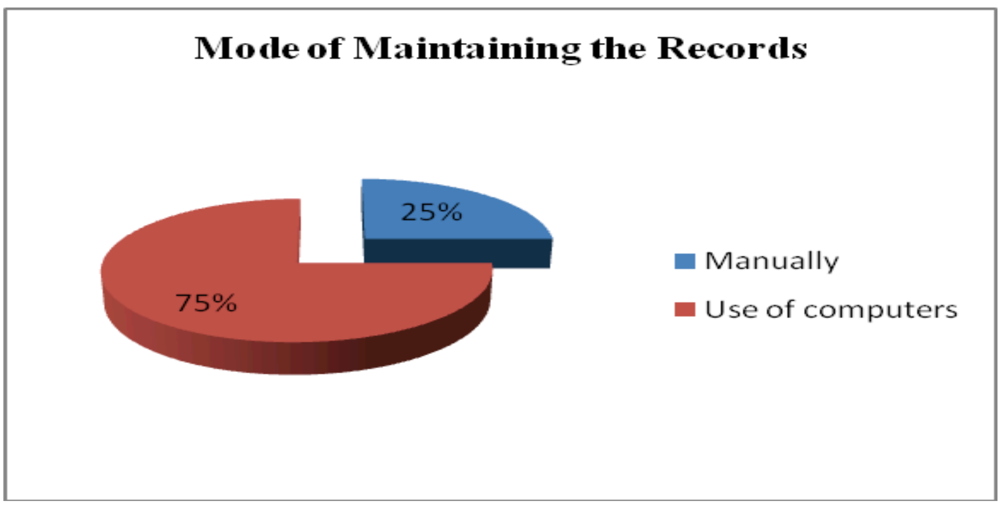


Table 4.5: Donors of the Institutions

	Frequency	Percent
Members or SACCOs	24	66.7
Churches and other institutions	9	25.0
Individual owners	3	8.3
Total	36	100.0

The study also sought to find out who the donors of the micro finance institutions in Murang'a Town were. From the findings, the majority of the respondents reported that the institutions were financed by the members or SACCOs as indicated by

66.7% of the respondents, 25% of the respondents said that they were financed by churches and other institutions, while 8.3% of the respondents said that the institutions were financed by the individual owners. This information was also shown in the figure below.

Figure 4.6: Financiers of the Institutions

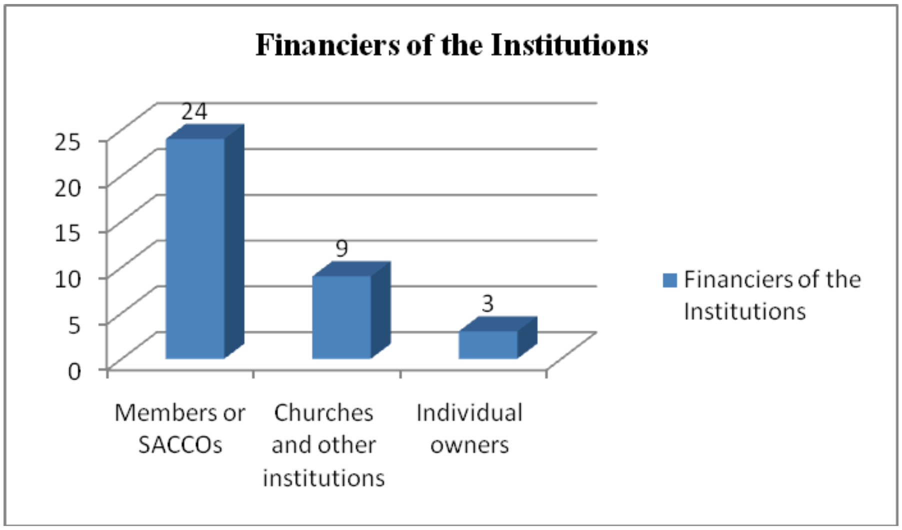


Table 4.6: Expenditures of the Institutions

	Yes	No
Salaries	100	0
Allowances	83.3	16.7
Rent for business premise	94.4	15.6
Stationeries	100	0
Transport	88.9	11.1

The respondents were also requested to state the expenditures of the microfinance institutions. According to the respondents, these expenditures were salaries and stationeries as indicated by all the respondents, rent for business premise as shown by 94.4% of the respondents, transport as indicated by 88.9% of the respondents and also allowances as shown by 83.3% of the respondents.

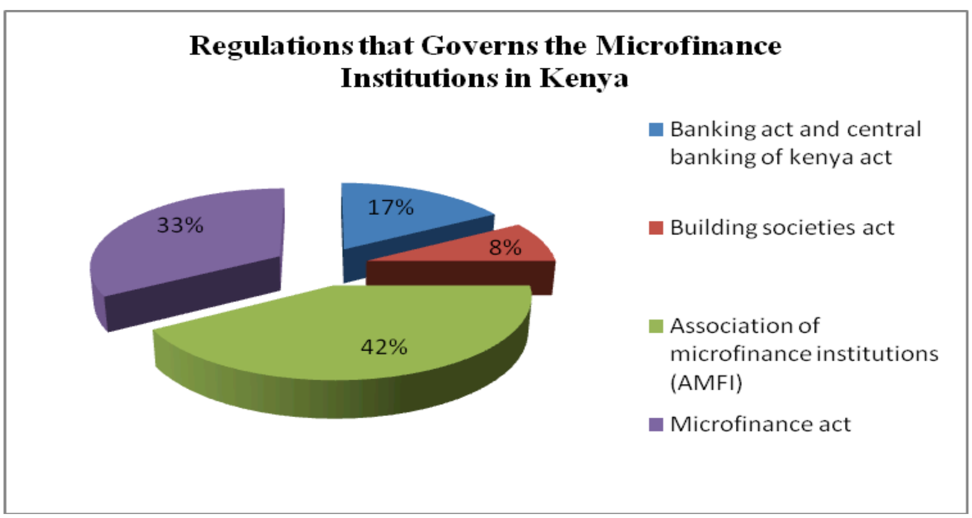
4.3: Financial Regulations

Table 4.7: The Regulations that Governs the Microfinance Institutions in Kenya

	Frequency	Percent
Banking act and central banking of Kenya act	6	16.7
Building societies act	3	8.3
Association of microfinance institutions (AMFI)	15	42.7
Microfinance act	12	33.3
Total	36	100.0

The respondents were also requested to state the regulation that covers the role of microfinance institutions in Kenya. According to the findings, the majority of the respondents as shown by 42.7% felt that the Role of Microfinance Institutions in Kenya was covered by the Association of microfinance institutions (AMFI), 33.3% of the respondents were of the view that they were covered by Microfinance act, 16.7% said Banking act and central banking of Kenya act, while 8.3% of the respondents said that the microfinance institutions were covered by the building societies act. The pie chart below was also used to represent this information.

Figure 4.7: The Regulation That Governs the Microfinance Institutions in Kenya



The respondents were also requested to indicate whether there was a body that supervises microfinance institutions. From the study, all the respondents reported that there was a body that supervised the microfinance institutions. These bodies include; the Central Bank of Kenya.

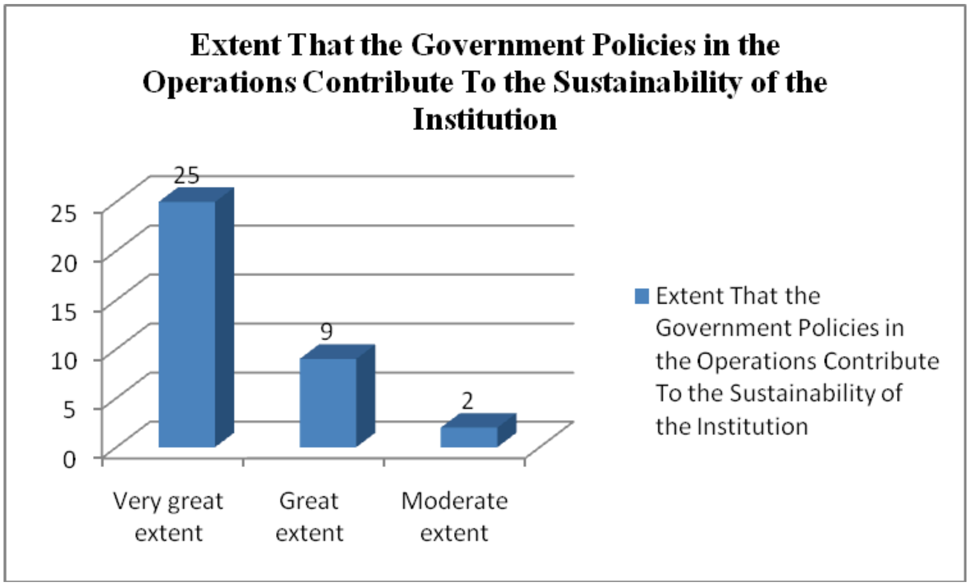
The regulations that govern the microfinance institutions have a great effect on their operations as they regulate and supervise their operations to protect customers' deposits, and to ensure that reckless lending does not threaten the stability of the wider financial system. The regulatory authorities also react to political pressure to regulate and supervise microfinance institutions operations.

Table 4.8: Extent That the Government Policies in the Operations Contribute To the Sustainability of the Institution

	Frequency	Percent
Very great extent	25	69.4
Great extent	9	25.0
Moderate extent	2	5.6
Total	36	100.0

The study also sought to find out the extent that the government policies in the operations contribute to the sustainability of the microfinance institutions. from the study, most respondents as indicated by 69.4% reported that the government policies contribute to the sustainability of the institutions to a very great extent, 25% of the respondents said to a great extent, while a small proportion of respondents as indicated by 5.6% said to a moderate extent. This information shows that government policies had a great influence on the sustainability of microfinance institutions. The information in the above table was also shown in the bar chart below.

Figure 4.8: Extent That the Government Policies in the Operations Contribute To the Sustainability of the Institution



4.4: Type of Customers Served

Table 4.9: Main Target Clients

	Frequency	Percent
Individual	24	66.7
Institutions	3	8.3
SACCOs	9	25.0
Total	36	100.0

The researcher also sought to find out the main targets clients of the microfinance institutions. According to the study, the main targets customers to these institutions were the individual clients as shown by 66.7% of the respondents, 25% said that their target clients were the SACCOs, while a small proportion of the respondents reported that their main target clients were the institutions. The figure below was also used to shown this information.

Figure 4.9: Main Target Clients

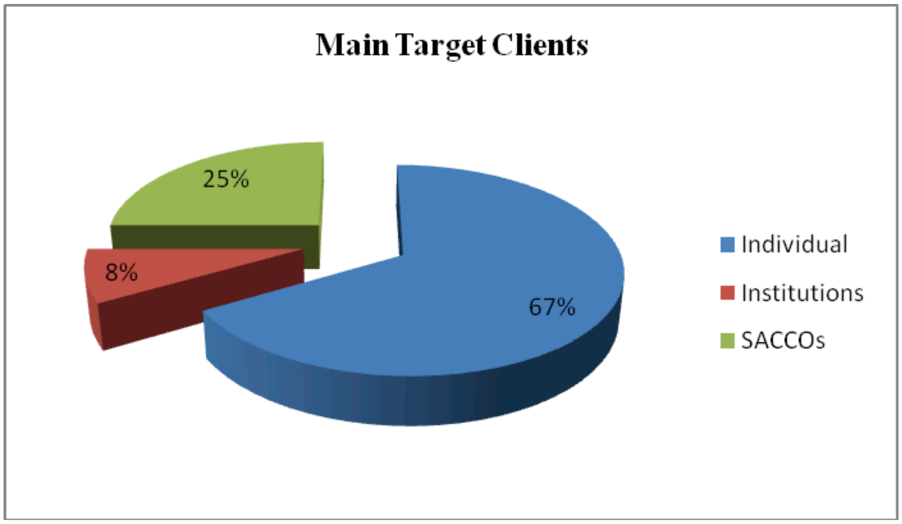


Table 4.10: Average Level of Monthly Income of Individual Clients

	Frequency	Percent
Less than Kshs 3000	3	8.3
Kshs 3001-7000	3	8.3
Kshs 7001-12000	12	33.3
Kshs 12001-20,000	15	42.7
More than Kshs 20,000	3	8.3
Total	36	100.0

The respondents were also requested to indicate the average level of income of individual clients. From the findings, the majority of the respondents as shown by 42.7% reported that the average level of income of individual clients was Kshs 12,001-20,000, 33.3% of the respondents said their income ranged between Kshs 7,001-12,000, while the respondents who reported that the average level of income of individual clients was less than Kshs 3,000, Kshs 3,001-7,000 and Kshs more than Kshs 20,000 were shown by 8.3% of the respondents in each case. This information was also shown in the figure below.

Figure 4.10: Average Level of Monthly Income of Individual Clients

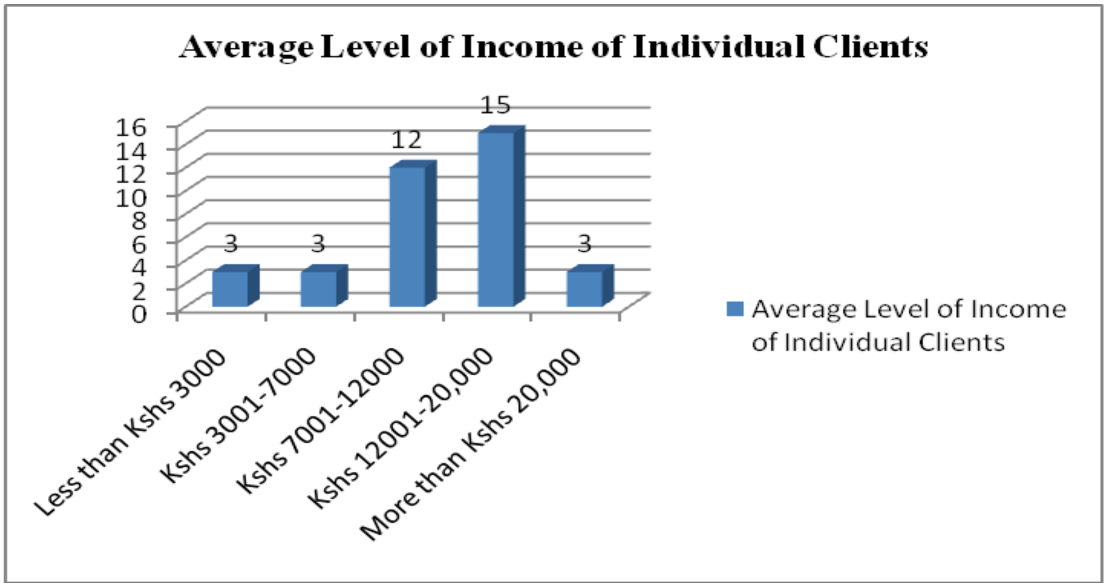
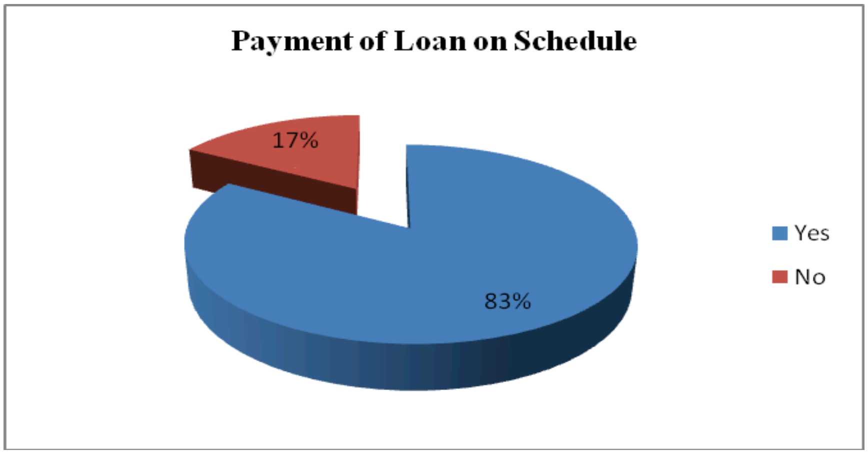


Table 4.11: Whether Clients Pay Loan On Schedule

	Frequency	Percent
Yes	30	83.3
No	6	16.7
Total	36	100.0

From the findings in the above table, the researcher found that the majority of the clients pay loan on schedule as shown by 83.3% of the respondents, while 16.7% of the respondents reported that their clients do not pay loan on schedule. This information was also shown in the figure below.

Figure 4.11: Whether Clients Pay Loan On Schedule



Policies Regarding Non-Payment of Loans in Microfinance Institutions

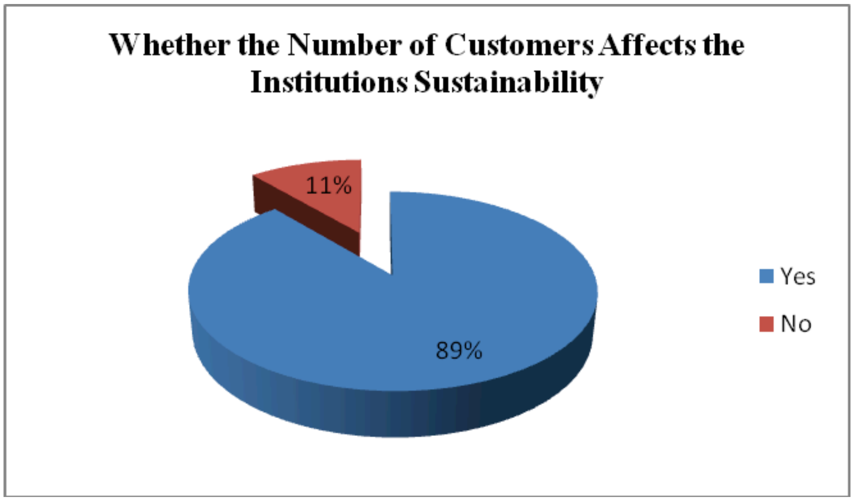
From the study, the researcher found that incase the clients fail to pay back the loans, the microfinance institution either sells off the property of the client to replace the loan or the loan is transferred to the guarantor to pay the loan.

Table 4.12: Whether the Number of Customers Affects the Institutions Sustainability

	Frequency	Percent
Yes	32	88.9
No	4	11.1
Total	36	100.0

From the findings in the above table, the study found that the number of customers served by the microfinance institutions affects the institutions sustainability as indicated by majority of respondents shown by 88.9%. In this case, the number of customers served can affect the institutions sustainability positively or negatively. That is the more the customers served the higher chances of sustainability and the less the customers served the lower chances of sustainability. 11.1% of the respondents felt that the number of customers served did not affect the institutions sustainability. This information was also shown in the figure below.

Figure 4.12: Whether the Number of Customers Affects the Institutions Sustainability



4.5: Geographical Coverage in Murang'a Town

Table 4.13: Number of Clients That the Microfinance Institutions Had By the End of the First Year of Operation in Murang'a Town

	Frequency	Percent
Less than 100	4	11.1
101-200	10	27.8
201-300	15	41.7
301-400	5	13.8
0ver 400	2	5.6
Total	36	100.0

The respondents were also requested to indicate the number of clients that the microfinance institutions had by the end of the first year of operation in Murang'a Town. From the study, the majority of the respondents as indicated by 41.7% said that their microfinance institution had 201-300 clients by the end of the first year of operation in Murang'a Town 27.8% of the respondents said that they had 101-200 clients, 13.8% of the respondents said that they had 301-400 clients, 11.1% of the institutions had less than 100 clients, while 5.6% of the respondents reported that they had over 400 clients by the end of the first year of operation in Murang'a Town. This information was also shown in the figure below.

Figure 4.13:

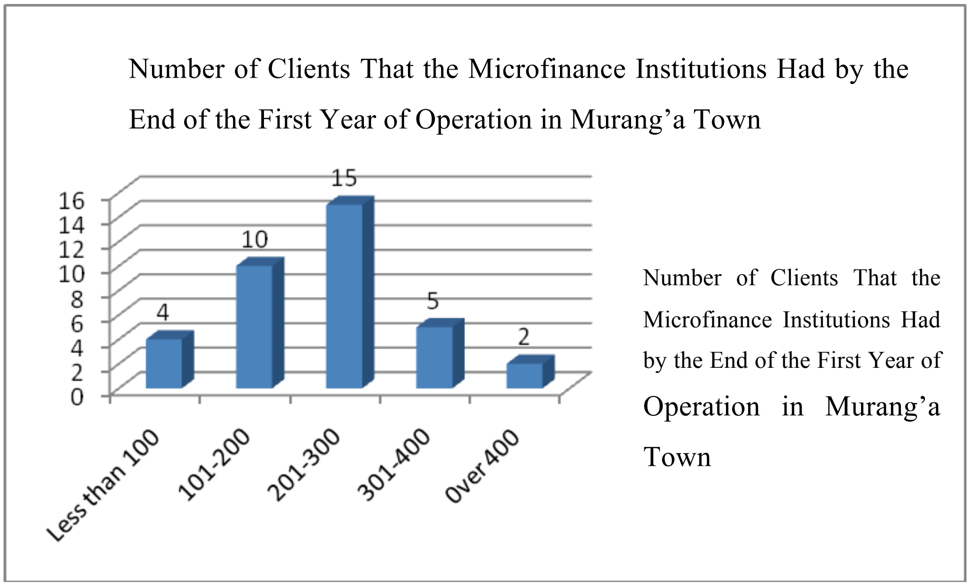


Table 4.14: Number of Clients Currently

	Frequency	Percent
Less than 200	3	8.3
201-500	2	5.6
501-800	4	11.1
801-1100	14	38.9
1101-1400	8	22.2
More than 1400	5	13.9
Total	36	100.0

The study also sought to find out the number of clients that the microfinance institutions in Murang'a Town have currently. From the study, the majority of the respondents said that in their microfinance institution, they had 801-1100 clients currently this was shown by 38.9% of the respondents, 22.2% said that they had 1101-1400 clients currently, 13.9% of the respondents reported that they had more than 1400 clients currently, 11.1% said that they had 501-800 clients currently, 8.3% of the institutions had less than 200 clients, while a small proportion of respondents as indicated by 5.6% reported that they had 201-500 clients currently. This information was also shown in the figure below.

Figure 4.14: Number of Clients Currently

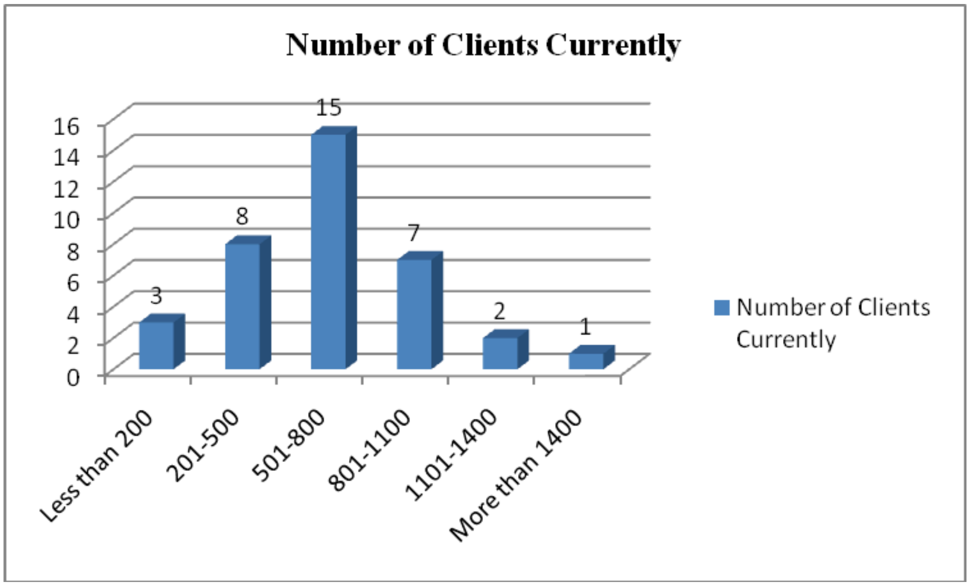
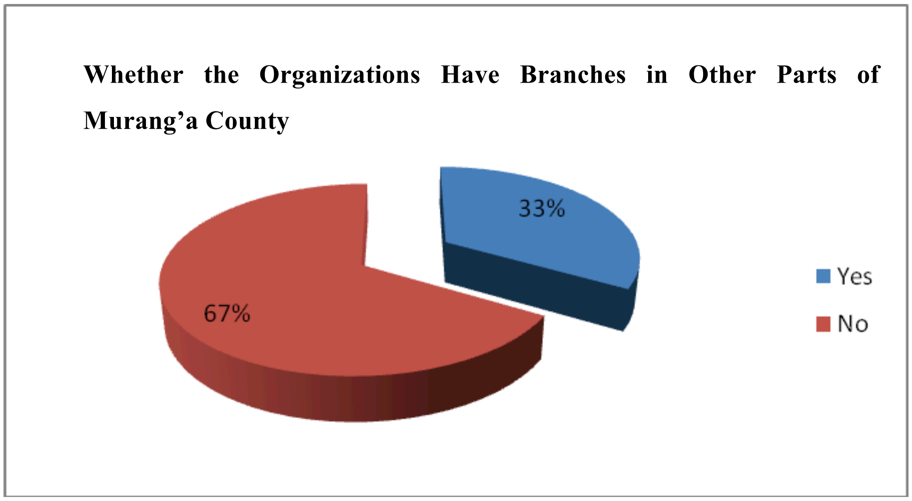


Table 4.15: Whether the Organizations Have Branches in Other Parts of Murang'a County

	Frequency	Percent
Yes	12	33.3
No	24	66.7
Total	36	100.0

The study also sought to find out whether the microfinance institutions have branches in other parts of Murang'a District. From the study, the researcher found that most of the organizations did not have branches in other parts of Murang'a as shown by 66.7% of the respondents, while 33.3% of the respondents reported that their organizations had other branches in Murang'a District. This information was also shown in the figure below.

Figure 15: Whether the Organizations Have Branches in Other Parts of Murang'a County



Whether the Institutions Give Financial Services to the Micro Enterprises

The study also established from all the respondents that the microfinance institutions give financial services to the microenterprises.

How the Institutions Can Sustain Their Operations in Case They Do Not Have Donor Funds

The study also sought to find out from the respondents how the microfinance institutions can sustain their operations incase they do not have donor funds. From the study, the respondents said that the institutions can use the customers' savings, they can use the interest from the loans given to their clients and also the institutions can invest in other businesses to help increase their capital in order to sustain themselves.

Table 4.16: Factors Influencing the Sustainability of the Microfinance Institutions

	no extent	less extent	moderate extent	great extent	very great extent	mean
The number of customers the MFI serves	0	0	8.3	16.7	75	4.7
The government policies related to MFIs and financial policies	0	8.3	8.3	25	58.3	4.3
The geographical coverage of the institution	0	0	0	33.3	66.7	4.7
The volume of credit offered to the customers of the MFI	0	8.3	16.7	25	50	4.2
Management of microfinances	0	0	8.3	27.8	63.9	4.6
Technology	0	8.3	41.7	30.6	19.4	3.6
Qualification/motivation of the staff	0	0	11.1	27.8	61.1	4.5

Finally, the researcher sought to find out in general the factors that influenced the sustainability of the microfinance institutions. From the study, the factors that influenced the sustainability of microfinance institutions to a very great extent were; the number of customers the MFI serves and the geographical coverage of the institution as shown by a high mean score of 4.7 in each case, the management of the microfinances as indicated by a mean score of 4.6 and qualification/motivation of the staff as shown by a mean score of 4.5, while the factors that influenced the sustainability of microfinance institutions to a great extent included; government policies related to MFIs and financial policies as shown by a mean score of 4.3, the volume of credit offered to the customers of the MFI as shown by a mean score of 4.2 and technology as shown by a mean score of 3.6.

Challenges Experienced

The respondents were also requested to state the challenges that are experienced in running the microfinance institutions. From the findings, the greatest challenge was found to be non-payment of loan by the customers as shown by 88.9% of the respondents. Other challenges were; Interest rate risk shown by 63.9% of the respondents, poor management of the institutions shown by 58.3% of the respondents, so much borrowing from the customers shown by 50% of the respondents and also government policies, which sometimes pose a very great challenge to the institutions as shown by 41.7% of the respondents.

Respondents Recommendations on Sustainability

The researcher also requested the respondents to give recommendations on sustainability. From the study, most of the respondents recommended that the institutions should be run by qualified members of the management shown by 92% of the respondents; there should be effective regulation and supervision of the operations of the microfinance institutions shown by 88.9% of the respondents, the institutions should consider also attracting the most poor people in their regions by giving them loans at much lower interests as shown by 50% of the respondents and also the institutions should have a thorough survey on their customers before they advance loans to them to ensure that the client is creditworthy shown by 41.7% of the respondents.

CHAPTER FIVE: SUMMARY, CONCLUSIONS AND RECOMMENDATION

5.1: Summary of the Findings

From the analysis the following summary, conclusions and recommendations were made. The analysis was based on the objectives of the study. The study sought to assess the factors that influence the sustainability of microfinance institutions in Murang'a Town.

From the research, the researcher found that the majority of the microfinance institutions had been in operation in Kenya for over 5 years and also most of them had been in operation in Murang'a for 2-5 years. This clearly indicates that these organizations were well versed with the factors of the sustainability of these microfinance institutions as they had been in operation for a considerably long time. The study also found that most of these institutions had 15-25 employees. It was also clear that most of the microfinance institutions maintained their records by the use of computers. According to the study, most of the institutions were financed by the members or SACCOs. These institutions also incurred expenses, which included; salaries to the employees, stationeries, transport, allowances and rent for the business premises.

On financial regulations, according to most respondents, most of the microfinance institutions were governed by AMFI regulations. All the micro finances had a body, which supervises them according to the respondents. The laws that govern the institutions regulate and supervise the institutions operations to protect customers' deposits, and to ensure that reckless lending does not threaten the stability of the wider financial system and they also react to political pressure to regulate and supervise microfinance institutions operations. The government policies also contribute to the institutions operations, which lead to the sustainability of the institutions to a very great extent.

On the type of customers served, the study found that the main target clients to the microfinance institutions are the individual clients and the majority of them earned Kshs 12,000-20,000. The study also revealed that most of these clients paid loan on schedule and most of them are organized in groups. Incase there is a non-payment of loan, most of the microfinance sell off the property of the client to pay the loan or the loan is transferred to the guarantor. The study also revealed that the number of customers affect the institutions sustainability.

From the study, the researcher found that most of the micro finances had between 200 and 400 clients by the end of their first year in operation in Murang'a Town, while most of them have over 500 clients currently. The study also revealed that most of these organizations do not have branches in other parts of Murang'a. The study also found that these microfinance institutions give financial services to the micro enterprises. Incase the institutions do not have donor funds, the respondents suggested that the only way to sustain the institutions is by pooling back the profit earned from the interest as a result of the loans given to the customers and also investing in other types of businesses.

In general, the researcher found that the number of customers the MFI serves and the geographical coverage of the institution influenced the sustainability of the microfinance institutions to a very great extent, while the government policies related to MFIs and financial policies and the volume of credit offered to the customers of the MFI influenced the sustainability of microfinance institutions to a great extent.

The study also found that the challenges that were experienced in running the microfinance institutions were non-payment of loan by the customers, interest rate risk, poor management of the institutions, so much borrowing from the customers and also government policies, which sometimes pose a very great challenge to the institutions.

The respondents therefore recommended that the institutions should be run by qualified members of the management; there should be effective regulation and supervision of the operations of the microfinance institutions, the institutions should consider also attracting the most poor people in their regions by giving them loans at much lower interests and also the institutions should have a thorough survey on their customers before they advance loans to them to ensure that the client is creditworthy.

5.2: Conclusions

From the study, the researcher concluded that the government policies related to MFIs i.e. law that covers the microfinance in Kenya, and the supervision of the microfinance institutions influences the success and the sustainability of the microfinance institutions.

It was also concluded that the repayment rate from the credit offered i.e. clients paying back loan on time also ensures the sustainability of microfinance institutions. This is because from the credit offered to the clients, the institutions get the interest, which is very necessary for the sustainability of these institutions.

The study also concluded that the number of customers served and their geographical coverage influence the sustainability of microfinance institutions to a great extent.

5.3: Recommendations

From the findings and conclusions, the study recommends that microfinance institutions should open many branches so that they can be able to reach as many people as possible which will enhance their sustainability.

The study also recommends that for the microfinance institutions to survive well in the market, and also to ensure that they conform to the rules and regulations regarding registration, adherence to the government policies.

The researcher also recommends that the institutions should be run by qualified members of the management. There should be effective regulations and supervision of the operations of the microfinance institutions. The institutions should consider also attracting the poorest people in their regions by giving them loans at much lower interests and also the institutions should do a thorough vetting on their customers before advancing loans to them to ensure that they are creditworthy. They should increase clients base by introducing more products

5.4: Recommendations for Further Research

Further research should be conducted in other types of banks e.g. commercial banks to find out the factors that influence their sustainability.

The response rate should also be broadened in further studies in order to get more responses so that the researcher can make better generalizations.

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