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ASSESSMENT OF THE INFLUENCE OF FINANCIAL FACTORS ON THE GROWTH OF MICROFINANCE INSTITUTIONS IN BAHATI SUB-COUNTY, KENYA

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Abstract

The study aimed to assess the financial factors (viz. financial literacy and interest rates influence) affecting the growth of microfinance institutions (MFIs) in Bahati Sub-county, Kenya. The study was guided by stage theories of growth, models of organizational capabilities, and Greigner's growth model. The study adopted descriptive research design. The study targeted all the 117 employees working with the 20 MFIs in Bahati Sub-county. A sample of 54 respondents was drawn using stratified random sampling. Data collected through structured questionnaire was analyzed using SPSS employed descriptive and inferential statistics. It was established that most of employees working with MFIs had been trained on matters of finances. It was noted that MFIs generally charge higher interest rates than commercial banks. The study findings indicated that there exists a strong, positive and statistically significant relationship between financial literacy and growth of MFIs; whereas relationship between interest rates and growth of MFIs was not statistically significant. The study found that MFIs charge higher interest rates than commercial banks. The study recommends that MFIs should continuously enlighten their employees on financial matters and MFIs should ensure that there is no huge disparity between the interest rates they charge and those ones charged by other lending institutions.

Keywords: Commercial Banks, Financial Literacy, Financial Matters, Growth, Interest Rates, Microfinance Institutions

INTRODUCTION

Microfinance industry is a unique field in different aspects such as its newness, its diverse organizational structure (with profits and non-profits), and its social mission whereby it largely focuses on the women and the poor (Mori & Randoy, 2011). This is supported by Cull et al (2009) who argued that microfinance institutions (MFIs) target to offer financial services to the poor in the society. In other words, MFIs facilitates access to financial services by the poor and also plays a pivotal role in development of the focal community. In light of this, the growth of MFIs is very important since the implications of the same are likely to have far-reaching effects on not only those firms but also the people and entities that directly and indirectly depend on them.

The concept of microfinance institutions can be traced back to the early 1700s through the work of Jonathan Swift, an Irishman, who created the bank for the rural-poor in Ireland (Abera, 2012). Muhammad Yunus from 1970s championed the modern concept of microfinance. He founded the Grameen bank in 1994 from concepts he had advocated for since 1970s (Mbithe, 2010). The bank was formed from Yunus own money that he had lent to Crest women whom he trusted would pay back (Waliula, 2013). Since then Grameen bank has gained a lot of international attention wining Yunus a Nobel Peace prize in 2006.

In Canada and the USA, the microfinance organizations target marginalized populations unable to access mainstream bank financing as close to 8% of American are unbanked (Mutai, 2012). This means that 9 million Americans are without any kind of bank account or formal finance services. In Canada, the microfinance took shape through the development of credit unions. The credit unions provided financial services to Canadians who could not access to traditional financial means (Mutai, 2012).

As an industry, micro finance is a relatively new phenomenon in Kenya, with a few agencies starting about two decades ago. The microfinance sector started gaining the status of an industry only in the last 10 years (Orua, 2009). The Government of Kenya (GoK) has indirectly provided a boost to the microfinance sector. During 1992-1994, the GoK implemented a Structural Adjustment Program that resulted in the liberalization of the economy (Waliula, 2013). To counter the possible initial negative social effects of the liberalization process, the GoK identified areas and projects needing external donor support, including small-scale and micro enterprises (Wube, 2010). Lack of access to credit was considered a major bottleneck for entrepreneurial development. Kenya Rural Enterprise Programme (K-REP) can be considered the pioneer of NGO micro-finance in Kenya. The experimental and financing activities of K-REP have had far-reaching consequences, influencing the outreach modalities and outreach of quite some other NGO-MFAs (Barnes, Gaile, & Kibombo, 2010). With generous support from USAID, K-REP was designed as an intermediary NGO in 1984 to provide credit and technical assistance to other NGOs in Kenya (Mutai, 2012).

In Kenya, there are 34 registered microfinance institutions. Varied institutions including companies, cooperative societies, trusts, non-governmental organizations (NGOs) state corporations and informal operators such as moneylenders carry out microfinance in Kenya (Maobe, 2013). Sometimes the microfinance activities comprise of social welfare aspects. Kenya has more exposure to microfinance than any other country in Sub-Saharan Africa, with micro-credit programmes dating back to the early 1980s (Oseno, 2013). Among the major players in the sector include Faulu Kenya, Kenya Women Finance Trust (KWFT), Small and Medium Enterprise Programme (SMEP), Kenya Small Traders and Entrepreneurs Society (KSTES), Ecumenical Loans Fund (ECLOF) and Vintage Management amongst others (Waliula, 2013). Nevertheless, not much regarding the growth of MFIs in Kenya has hitherto been document. It is against this backdrop that it was necessary to examine the various financial factors that influence growth of MFIs in Kenya.

Statement of the Problem

Despite the fact that microfinance institutions are providing critical services for the Kenyans, the industry is confronted by a myriad of challenges (Omari, 2012). Such as interest rates collateral and financial literacy. Response to problems of hidden information is to require that borrowers provide collateral meaning an asset that the lender can easily seize and perhaps sell in the event of default (Nyawach, 2011). This allows banks to charge low interest rates even in the face of poor information about borrower’s prospects. But many of the impoverished borrowers that micro finance reaches lack assets that can effectively serve as collateral. When they do have assets, they are often in illiquid (Simba, 2013). Livestock for example is not only subject to destruction but can be very difficult to convert on market for a tradition bank in experienced in selling. Furthermore among these sorts of clients the only assets they have may be critical to their means of subsistence and give legal or ethical restriction may prevent banks from foreclosing upon them (Obota, 2013).

Most micro-finance institutions in Kenya charges interest rates that range from between 1.8% to 2.5% per month. This translates to be 21.6% to 30% per year whereas commercial banks lending rates are between 21% and 24%. This difference adds up over time. In fact, given this discrepancy it can be argued that MFIs are fleecing the poor and taking advantage of them because poor people are so desperate for credit and they will even accept expensive credit. The reason for charging high interest rate is risky due to assumed high likelihood that the borrower will default at some point. Microfinance institutions need to grow and prosper, especially in light of the fact that ultimately, they are financial institutions and they cannot afford a perception of being unable to meet their financial obligations. In view of these, there is need for each organization's management to know the financial aspects that influence the success and growth of the microfinance institutions (Mwohe, 2013). The knowledge of these factors leads to the creation of effective strategies to counter them and hence succeed (Richards, 2006). This study aimed to bridge this research gap.

General Objective

To assess the financial factors affecting the growth of microfinance institutions in Bahati Sub-county, Kenya

Specific Objectives

i. To examine the extent to which financial literacy influences the growth of MFIs in Bahati Sub-county
ii. To analyze the extent to which interest rates affect the growth of MFIs in Bahati Sub-county

THEORETICAL FRAMEWORK

Stage Theories of Growth

There have been numerous attempts over the years to identify life cycles of firms, model their evolution or even pick out identifiable stages through which they grow. Simba (2013) argued that firms evolve through five phases, each characterized by a period of relatively stable growth. These phases, which he identified with a label which indicates the nature of the management problem characteristic of each: "creativity, "direction", "delegation", "coordination" and "collaboration" are separated by four crises of leadership, "autonomy", "control" and "red tape". More recently, Garnsey (1998) as cited by Natukunda (2010) developed a model of corporate growth which traces out a set of phases which correspond to the development and deployment of new internal resources in young firms. But Chemitei (2013) argued that what a firm does, that is, its propensity to maximize profits or sacrifice profits for growth varies with age (and other factors like investment opportunities). A strictly profit maximizing firm is likely to enjoy only a finite burst of growth associated with each innovation. However, if the innovation fuels enough growth to weaken the power of shareholders, then managers will gradually acquire some room to exercise discretion (Ngomo, 2012). Since they are liable to be more interested in the size or growth of the firm than its profits, they will take advantage of this discretion to reinvest too much of the proceeds from the innovation into this or other investment opportunities. Consequently, "too much" growth is likely to be associated with each innovation, and it is likely to go on for "too long" (Waliula, 2013).

Entrepreneurial firms eventually outgrow their founders and become bureaucratic institutions, all firms mature and may decline and disappear, and they are often a useful aid to conceptualization. However, even if all firms progress through all five of Greiner's phases, they are likely to do so at very different rates and will probably enjoy different growth rates in each phase (Orua, 2009) . Similarly, although it is not hard to believe that goals of a firm change systematically over time, it is hard to know exactly how one might see this in the data on annual growth rates. The point here is that this theory posits that there are secular or long run deterministic trends in the pattern of growth of firms. Simba (2013) noted that growth rates display stochastic trends, that is, firm size evolves in an erratic and unpredictable manner over time. Current period shocks which propel a random walk are permanent, and as a consequence, their effect in the long run is almost the same as it is in the short run. The firm's human resource level of competence also has a major role to play so as to enhance outreach or market share (Maobe, 2013).

Models of Organizational Capabilities

This theory by Penrose posits that firms can be viewed as bundles of resources bound together by a set of administrative skills or capabilities which are used to deploy them as effectively as possible. Orua (2009) points out that successful firm can be understood in terms of hierarchy of practiced organizational routines, which define lower order organizational skills and how these are coordinated, and higher order decision procedures for choosing what is to be done at lower levels. These routines are part of a firm's resource base and they define what the organization is capable of doing or what its competencies are. These skills are viewed as bundles of skills and one of the more important repositories of tacit knowledge inside firms. Since knowledge is the foundation of organizational capabilities or competencies means two things: first, that these competencies are not assets (and do not, therefore appear on balance sheets and cannot be bought and sold) and second that they can only be learned or maintained through use (Akuku, 2009).

Barnes et al. (2010) argues that there is an intimate and tacit knowledge of the firm's resources, capabilities, organizational structures, standard operating procedures, unique historical conditions, and personnel, including human capital asset specificity. The fact is that the management adopted by any firm plays an integral role in the growth of that particular firm. This is because decision making is subjective and allocation of the firm's resources determines the overall performance of the entity. Managerial capability is the binding constraint that limits growth rate of the firm, the so called Penrose effect; for instance, limits on the absorption of modern technology (Natukunda, 2010).

Each firm is likely to be born with some particular skill or knowledge base and then develop it idiosyncratically over time as it uses what it has inherited and what it has learned to develop new skills and an augmented knowledge base. This then means that each firm's development is likely to be path dependent. The basic premise of this work is that competitive advantage is based on the possession of a few key resources and routines, organizational capabilities or core competencies and despite the proliferation of labels, there is some measure of agreement on what this actually means (Wangu, 2011). If competitive advantage is based on the possession of core competencies, then firms are likely to be heterogeneous (because competencies are unique) and realize different levels of performance over long periods (Makoani, 2013).

EMPIRICAL REVIEW

Empirical studies touching on financial literacy, interest rates, and growth of microfinance institutions are reviewed.

Financial Literacy

Organization for Economic Cooperation and Development (OECD, 2005) state that financial literacy comprises the combination of consumers and investors' understanding of financial products and concepts and their ability to make informed choices and decisions in cognizance of the risks and opportunities in order to know where they can seek help and better their financial wellbeing. In light of the aforementioned World Bank (2009) reports on studies conducted in Australia and in the United States that 72% and 82% of the respondents interviewed could not calculate compound interest; a basic skill in financial literacy. It is further reported that consumers overestimate their financial skills and knowledge but do not practice basic financial skills such as budgeting and developing regular saving plans. Moreover studies and surveys conducted in Australia, Canada and in the United Kingdom concur with the aforementioned that consumers are overconfident about their financial literacy but cannot solve basic financial problems. World Bank further states that overconfidence by such consumers may predispose them to entering in contractual agreement with financial service providers while ignoring important information or basic prudence measures. While quoting United Kingdom Department For International Development (DFID), 'UK backs lessons in Banking to help Africa' (2008),Word bank state that financial literacy among consumers in India is even worse. Lack of financial literacy is associated with the lack of access to financial products and failure to use them even when they are available. However, Shreiner and Sherrradan (2007) in their study on saving and asset building in individual development accounts in United States found that higher savings is correlated to training received among the consumers. This concurred with an earlier study by Bernheim and Garret (2003).

Lusardi and Mitchell (2014) in their paper on economic importance of financial literacy report that in the national financial capability survey conducted between 2009 -2012 depicted a financial knowledge gap among adult population in the United States. It is further reported that only 21% of the Americans interviewed knew about the relationship between bond prices and interest rates. While quoting Moore (2003), Lusardi et al states that people interviewed in Washington frequently failed to understand interest compounding along with the terms of consumer loans and mortgages. Further, respondents were seen to lack understanding on risk literacy as noted by Lusardi et al while quoting Lusardi, Schneider and Tufano (2011).As noted the study, most US respondents are financially illiterate.

DFID,'UK backs lessons in Banking to help Africa'(2008) reports that in a survey conducted in Zambia and other six African countries, only 29% of the adults interviewed had a bank account and 50% of them do not use financial products at all. Godfery (2008) in his paper on the economic case for financial literacy states that in a survey conducted in South Africa, 60% of the respondents do not understand the term interest and two thirds of the respondents in a survey in Zambia are not familiar with the basic financial products and tools such as checking accounts, automated teller machines and debit cards. Atakora (2013) looked into measuring the effectiveness of financial literacy programs among traders in Kumasi, Ghana. The study found that there was inadequate financial literacy amongst the traders. Further, traders with high level of education exhibited higher financial knowledge than uneducated ones. The study also recommended that policy makers should ensure that customers access financial education through bank activities as most of them depicted deficient financial knowledge.

Cherotich (2013) carried out a study on the role of microfinance institutions in financial deepening in Kenya. The study aimed at determining how growth of MFIs has contributed to financial deepening in Kenya. Financial literacy, among others was one of the facets of financial deepening. The study analyzed 59 MFIs who were members of the association of microfinance institutions in Kenya. The study found that MFIs promote financial deepening evidenced from the increased number of depositors and borrowers therefore showing that more people can access financial services from the MFIs. Further, it was noted that loan portfolio, the number of active borrowers and the return on assets influenced the financial deepening by the MFIs. It was further established that financial growth and increase in outreach positively affected financial deepening. The study recommended a policy framework that promotes operations of the MFIs such as regulations not just for deposit taking MFIs in order to spur growth in the entire sector.

MFI are essentially banks for the previously “unbankable” population and have the same drive for the single bottom line as do the big banks. The IMFS engages financially illiterate individuals into financial deals when the MFI know these individuals genuinely have no true idea of what they are getting into. They lure these unsuspecting customers with the idea that they are getting access to free money yet these customers have no idea of what it will cost to service that loan (Atieno, 2013). MFIS lacks price transparency for many clients of MFIS it is impossible to calculate the true cost of a loan. With clients with a low level of financial literacy and a market lacking standardized pricing including winners of responsible business awards, issue loans with actual costs orders of magnitude higher than advertised costs.

Financial illiteracy impedes this that actually translates to an unfair treatment of the customer. Traditionally micro finance services are evolving into feature rich product that may be difficult for the target market to comprehend considering the low level of financial literacy it currently has(Milgo, 2013). There are also hidden and unclear terms and conditions, jargons in contract and fine that the customer is genuinely unaware of. Everyone faces financial service at one point or another. Customers ought to be aware of the appropriate redress mechanism not only in order to receive loses and prevent service delivery issue in future but also to give valuable feed back to MFIS through registered complaints (Njunji, 2013).

Interest Rates

Grenade (2007) examined on determinants of commercial banks interest rate spread. In Eastern Caribbean currency union for a period between 1993-2003.The study analyzed 8 foreign and 8 indigenous banks. Using panel data technique to measure the relevance of micro and macro factors in determining commercial banks interest rate spread over the period, the study found that spreads were rather strong and showed little signs of narrowing. Further foreign banks were noted to be operating with larger spreads compared to the indigenous banks. These spreads were attributed to the high operating costs, nonperforming loans, high level of market concentration and regulation of savings deposit rate by the central banks.

Sharpe and Suarez (2014) looked into the insensitivity of investment to interest rates. The study sought to examine the sensitivity of investment plans and interest rates by asking special questions to chief finance officers in the global business outlook survey conducted in the third quarter of 2012.It was found that most of the firms were insensitive of the decreases in the interest rates and only responsive to increases in the interest rates. The respondents cited ample cash or low interest rates as their reason for their own insensitivity to investment plans.

Further, it was noted that sensitivity to interest rate changes tended to be lower among firms that were not concerned about working capital management and also those that did not expect to borrow over the following year. Moreover Sharpe and Suarez found that investment was also less sensitive among firms with greater expectations of revenue growth.

Onyekachi and Okoye (2013) conducted study on the effect of bank lending rate on the performance of Nigerian deposit money banks. The study aimed at establishing the effect of lending rate and monetary policy rate on the performance of Nigerian money banks. The study found that lending rate and monetary policy rate have significant and positive effect on the performance of Nigerian deposit money banks. Rasheed (2010) on the other hand investigated on the interest rate determinants in Nigeria. Using the error correlation model, the researcher found that Nigerian financial sector had integrated more with the global market and that returns on foreign assets would play a vital role in the determination of local interest rates.

Mwangi (2014) examined the effect of lending interest rates on financial performance of deposit taking MFIs in Kenya. The study sought to establish whether a relationship between lending interest rates and financial performance of deposit taking MFIs really exists. The study analyzed five deposit taking MFIs for the period between 2009-2013.It was found that there exists a strong relationship between lending interest rates and financial performance of the deposit taking MFIs. Mwangi noted that in high interest rate environment, an increase in lending rates larger than increase in deposit rates result in pushing up MFIs' spreads. Further, when interest rates increase, lending rates adjust more quickly than deposit rates. This affects the demand for and allocation of loanable funds since high interest rates discourage borrowing. The study therefore recommended that deposit taking MFIs should manage their interest rate to improve their financial performance since it has a positive effect on their financial performance.

Mang'eli (2012) embarked into examining the relationship between interest rate spread and financial performance of commercial banks in Kenya. The study used descriptive research design and found that interest rate spread affects the performance of commercial banks. This is because it increases the cost of borrowing charged to the borrowers. Further, Mang'eli noted that regulations on interest rates have greater effect on performance of commercial banks. This is because regulations on interest rates determine the interest rate spread in banks and also help mitigate moral hazards incidental to performance of commercial banks. It is further noted that credit risk management technique affects the value of a bank's interest rate spread as interest rates are benchmarked against the associated non-performing loans. Nonperforming loans consequently affects the performance of commercial banks due to the follow up costs that are usually involved. Kipng'etich (2011) in another study on relationship between interest rates (independent variable) and return on equity with financial performance being the dependent variable established a positive relationship between interest rate and return on equity. However, interest rate effect on profitability was not significant in all the examined institutions.

Most micro-finance institutions in Kenya charges interest rates that range from between 1.8% to 2.5% per month. This translates to be 21.6% to 30% per year whereas commercial banks lending rates are between 21% and 24%. This difference adds up over time. In fact, given this discrepancy it can be argued that MFIs are fleecing the poor and taking advantage of them because poor people are so desperate for credit and they will even accept expensive credit. The reason for charging high interest rate is risky due to assumed high likelihood that the borrower will default at some point (Mutai, 2012). These high interest rates are egregious because MFIs in Kenya are generally funded through concessional loans from international development institutions unlike commercial banks which are dependent on customer deposits to grow their loan book (Waliula, 2013). Concessionary loans are loans bearing on interest rates or a rate that is below average cost. They are super cheap but MFIs have high interest rates that they charge customers despite the fact that they got their money on the cheap.

MFIs are asserted to be given grants or loans at favorable rates specifically because they are seen to be institutions that seem to be doing some form of "social good" that should be facilitated and encouraged (Mutai, 2012). Still their rates are high. They get loans at super cheap rates and thus benefit and rather than passing some of these benefits to their customers they stick to exorbitantly high interest rates and cream off their clients in the name of "risk" and benefit again despite the fact that some of the MFIS have a truly meager number of nonperforming loans (Waliula, 2013). Clients ought to be aware of the risks they face when entering financial contracts with MFIS. In some rural areas the option of where to bank of get a loan is truly limited and the person cannot shop around and compare product where there are multiple options (Omari, 2012). The products are not comparable either because the person doesn't truly understand the offers anyway. They have no choice but to accept offer given and the power clearly lies in the hands of the MFIS.

Growth of Microfinance Institutions

Mulunga (2010) examined the factors affecting growth of microfinance institutions in Namibia. The study aimed at identifying the problems that impact on the growth of MFIs in Namibia. The study found that lack of regulatory and policy framework, capital and high operational costs were the main challenges MFIs in Namibia faced. Regulations and MFI regulatory bodies were noted to be not in place and MFIs operated in vacuum. There were therefore no standardized industry practices to regulate the microfinance providers. Further, the existing microfinance providers were noted to lack adequate capital to lend out to clients and therefore reaching potential clients was a challenge. Mulunga further notes that high operational costs impacted adversely on the efficiency of MFIs. Cost recovery was constrained since the Usury Act stipulated the interest ceiling. MFIs were therefore not able to charge interest rates that would cover their costs. This contributed to lack of sustainability since all loan repayments were ploughed back to cover operational cost and therefore reducing further funds to be lent out. This has led to closure of many donor-funded MFIs when these donors withdraw their funds and the institutions cannot sustain their operations. The study recommended a formulation and implementation of a regulatory and policy framework, restrictions of savings mobilization and exit policies and plans for donors and microfinance service providers.

Gebremichael (2013) looked into the efficiency, outreach and sustainability of Ethiopian microfinance institutions. The study sought to examine the performance of Ethiopian microfinance institutions while focusing on efficiency, outreach and sustainability. The study found that efficiency of the MFIs in Ethiopia varied in respect to ownership structure. Government affiliated MFIs exhibited higher efficiency than non-governmental MFIs. Further, it was observed that Ethiopian MFIs have experienced moderate productivity growth over the study period. This moderate growth has been attributed to technical efficiency changes, that is, improvement in management rather than improvement in optimum size in these MFIs.

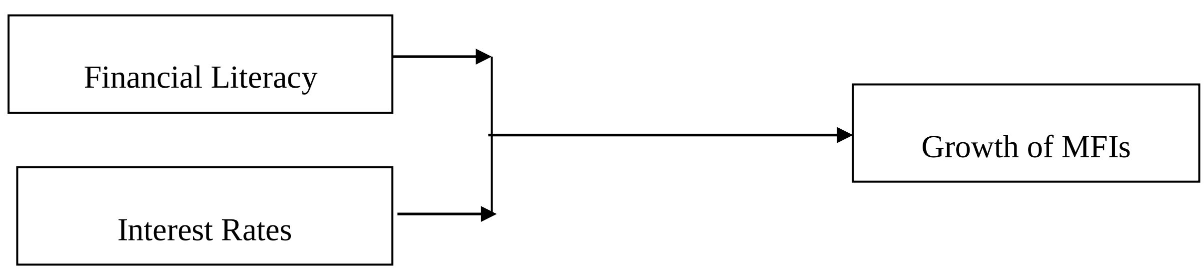
Nyamsogoro (2010) conducted a study on financial sustainability of rural microfinance institutions in Tanzania. He notes that the trend of total assets, a measure of growth of MFIs, has been on the rise, clocking United States Dollars (USD) 110 million in 2007 up from USD 10 million in 2003.Morever, it is noted that MFIs have had a stiff growth in their total assets from 2006.The owners wealth (equity) in the MFIs has also been noted to increase up from USD 10 million in 2001 to approximately USD 35 million in 2007. However, sustainability of the MFIs in the country has been put to question since MFIs have been performing poorly since 2005The return on assets; a measure of financial performance has been on the decline since 2005.This decline was however attributed to hard economic times.

Njoroge (2008) embarked on the potential growth of Kenya’s microfinance industry. The study sought to provide an overview of the ability of the microfinance industry to bridge the financial gap within the Kenya’s population. The study also investigated the different aspects between the Kenya’s commercial and non-commercial MFIs. The study found that Kenya’s MFI serve a very small percentage of the country’s adult population with only 1.7% of the adults using MFI services, but the potential for them to increase is still clear. Njoroge further notes that there still remains a large potential market for the microfinance industry. However, only commercial and profitable MFIs can survive and exploit the potential market. This is because such MFIs are able to reach and serve their client more effectively, meet their own costs and raise their own sufficient capital.

Ala and Ngugi (2013) conducted a study on the influence of mobile banking on the growth of MFI in Kenya. The study sought to investigate on the influence of mobile banking on the growth of microfinance institutions. The results depicted that access of financial services through mobile banking affects the growth of MFIs to a great extent. Further it is also noted that regulatory requirements influenced the growth of MFIs to strengthen the governance and internal control structures. This growth, as is further noted, provides sustained access to multiple sources of capital and also provides necessary comfort to chart plans for network expansion and increase outreach and scope of microfinance activities. Moreover, asset growth of MFIs would enable them source finance more frequently and increase their leverage. The study however recommended MFIs to ensure convenience, security of mobile banking though written guidelines and reduce duration of service delivery for efficient customer service.

Conceptual Framework

Figure 1: Conceptual Framework



As shown in Figure 1, the conceptual framework outlines two sets of variables; that is, independent and dependent variables. Independent variables are financial literacy and interest rates while the dependent variable is the growth of MFIs. It was hypothesized that the two aforestated financial factors influence the growth of MFIs.

METHODOLOGY

Research Design

A research design is a blueprint of conducting a study (Kothari, 2004). The study adopted descriptive research design. According to Gathondu (2013), the descriptive research design is concerned with finding out what, where and how of a phenomenon. On the other hand, Waliula (2013) argues that the major purpose of the descriptive research is to describe the state of affairs as it exists at the present. Kimaru (2013) further argues that the descriptive study attempts to describe or define a subject often by creating a profile of a group of problems, people or events, through the collection of data and tabulation of frequencies on research variables or their interaction. In this context, the study was interested in finding out the financial factors affecting the growth of the microfinance institutions in Bahati Sub-county.

Target Population

The target population describes the population to which the study findings are generalized. This study targeted all the 117 employees working with the 20 MFIs in Bahati Sub-County.

Sample Size and Sampling Procedure

The size of the sample should be scientifically determined in order for it to reflect the target population. In this regard, the study adopted Nassiuma's (2008) formula to calculate the size of the ample as illustrated below.

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

Where: n, N, C, e represent the sample size, the population, the coefficient of variation (0.5), and the precision level (0.05) respectively. The formula was used to calculate the sample as shown

$$n = \frac{117 \times 0.5^2}{0.5^2 + (117 - 1)\,0.05^2}$$

$n = 53.70$

$n =$ 54 respondents

The 54 sampled respondents were drawn from the target population using stratified random sampling method. This was due to the fact that each of the 20 targeted MFIs was distinct from the rest especially in terms of the employee distribution or number of staff. The stratified random sampling method ensured that each of the MFIs participated in the study and that sampling bias was minimized within each MFI.

Research Instrument

This study employed a structured questionnaire to collect data. The questionnaire was used because it was easy to administer on all the sampled respondents across the 20 MFIs in Bahati Sub-County. According to Nyawera (2013) questionnaire is the most common used data collection instrument especially when the respondents are relatively many and dispersed.

Validity and Reliability of the Research Instrument

The research questionnaire was pilot-tested in order to assess both its validity and reliability. The pilot testing was conducted on 12 employees of MFIs in Nakuru town. The collected data in this phase was subjected to validity and reliability tests. According to Waliula (2013), validity is defined as the extent to which differences in observed scale scores reflect true differences between objects on the characteristics being measured, rather than systematic or random error. On the other hand, Natukunda (2010) defines validity as the extent to which a set of measured items actually reflects the theoretical latent construct that those items are designed to measure. The study sought the expert opinions of the assigned university supervisors to assess the instrument's content validity.

According to Mutai (2012), reliability refers to the consistency and stability of the scores from a measurement scale. The Cronbach alpha coefficient was used to measure the instrument's reliability. The Cronbach alpha coefficients range between 0 and 1 with a minimal acceptance reliability values above 0.7 (Hildebrandt, 2014). The three instrument's constructs (financial literacy, interest rates and growth of MFIs) returned alpha values equal to 0.791, 837, and 0.742 respectively. This implied that the reliability threshold was attained.

Data Collection Procedure

Once the data collection instrument was validated and its reliability established the researcher obtained a letter of introduction from the University which facilitated the data collection from the sampled respondents. The letter explained about the study and its importance to the MFIs operating in Bahati Sub-County. The questionnaires were issued to the sampled respondents through the management of the respective MFIs. The filled ones were collected through the same avenue they were issued after approximately five working days.

Data Analysis and Presentation

The Statistical Package for Social Sciences (SPSS – Version 21) software was used.Descriptive statistic constituted frequencies, percentages, means, and standard deviations while inferential statistics comprised of Pearson's correlation and multiple regression analyses. The following is the regression model that guided the study.

$Y = \beta_0 + \beta_1X_1 + \beta_2X_2 + \varepsilon$

Where:

Y = Growth of MFIs

β_0 = constant

X_1 = Financial Literacy

X_2 = Interest Rates

ε = Error Term

β_1, β_2 = Regression coefficients

ANALYSIS AND FINDINGS

Response Rate

The sampled respondents were 54 MFIs' employees working in Bahati Sub-County of Nakuru County, Kenya. This implies that a total of 54 questionnaires were issued to the respondents. Out of this figure, the questionnaires that were successfully filled and collected totaled 41. This is equivalent to 75.93 per cent response rate. The relatively high response rate was occasioned by the fact that the administration of the research instrument was carried out by the researcher in person who clarified the importance of the MFIs' employees in participating in the study.

Descriptive Analysis and Interpretation

The study examined the opinions of the employees working with MFIs in Bahati Sub-County regarding financial factors that affect the growth of their firms. The factors studied include financial literacy and interest rates. Much of the data collected were on a 5-point Likert scale ranging from 1 to 5 which represented strongly disagree, disagree, undecided, agree, and strongly agree in that order.

Descriptive Analysis for Financial Literacy

The study examined the views of the respondents on financial literacy in their MFIs. The results of pertinent descriptive analysis are as shown in Tables 1 and 2.

Table 1: Training on Financial Literacy

	Frequency	Percent
No	15	36.6
Yes	26	63.4
Total	**41**	**100.0**

As Table 1 shows, majority of the staff working with MFIs (63.4%) admitted to having been trained on matters of finances against 36.6% who claimed they had not been trained on that subject. This indicated that the respondents generally understood issues touching on finances relative to MFIs.

Table 2: Descriptive Statistics for Financial Literacy

		n	Min	Max	Mean	Std. Dev
i.	Our MFIs conducts financial literacy sessions for its staff	41	1	5	3.80	.872
ii.	Financial literacy enlightens employees on credit appraisal of prospective borrowers	41	1	5	3.95	1.024
iii.	Financial literate employees are able to effectively recover debts borrowed by MFI customers	41	1	5	3.80	1.054
iv.	Financial literacy has led to the increase in the number of customers at our MFI	41	1	5	3.49	1.267
v.	Financial literacy has improved deposit mobilization in our firm	41	3	5	4.66	.530
vi.	Financial literacy has improved the uptake of credit facilities in our MFI of the microfinance institutions	41	2	5	4.37	.942

The study findings indicated that the respondents strongly concurred (mean = 4.66; std dev = 0.530) with the proposition that financial literacy has improved deposit mobilization in MFIs. The respondents were also in agreement (mean ≈ 4.00) with the argument that MFIs conducts financial literacy sessions for their staff; financial literacy enlightens employees on credit appraisal of prospective borrowers; financial literate employees are able to effectively recover debts borrowed by MFI customers; financial literacy has led to the increase in the number of customers at MFIs; and that financial literacy has improved the uptake of credit facilities in MFIs of in Bahati Sub-County.

Descriptive Analysis for Interest Rates

In tandem with the second study objective, the study analyzed the opinions of employees working with MFIs in Bahati Sub-County regarding interest rates charged by their entities.

Table 3: Descriptive Statistics for Interest Rates

		N	Min	Max	Mean	Std. Dev
i.	MFIs generally charge higher interest rates than commercial banks	41	1	5	4.07	.985
ii.	Interest rates affect the growth of MFIs	41	3	5	4.46	.596
iii.	The interest rate levels influence the demand levels of credit facilities	41	3	5	4.44	.594
iv.	The interest rates are determined by both external and internal factors	41	1	5	4.07	1.311
v.	Interest rates are largely influenced by external factors	41	2	5	4.22	.881
vi.	High interest rates partly contribute to default in loan repayment	41	3	5	4.15	.792

From the findings, the respondents admitted (mean ≈ 4.00) that MFIs generally charge higher interest rates than commercial banks; interest rates affect the growth of MFIs; the interest rate levels influence the demand levels of credit facilities; the interest rates are determined by both external and internal factors; interest rates are largely influenced by external factors and that high interest rates partly contribute to default in loan repayment.

Descriptive Analysis for Growth of MFIs

Lastly, the study examined the views of employees working with MFIs in Bahati Sub-County regarding the issue of collateral relative to their respective firms. Table 4 summarized their opinions.

Table 4: Descriptive Statistics for Growth of MFIs

		n	Min	Max	Mean	Std. Dev
i.	Our MFI has recorded increased number of account holders	41	1	5	4.00	1.025
ii.	The amounts of deposits have been increasing over the years	41	1	5	3.80	1.054
iii.	The amounts of loans borrowed have been on an upward trend	41	1	5	3.59	1.267
iv.	Our MFI has increased the number of its staff	41	4	5	4.68	.471
v.	The profits have increased over the years	41	2	5	4.37	.942

The findings indicated that respondents strongly admitted (mean = 4.68, std dev = 0.471) that MFIs have increased the number of their staff. In addition, the respondents concurred (mean ≈ 4.00) with the argument that MFIs have recorded increased number of account holders; the amounts of deposits have been increasing over the years; the amounts of loans borrowed have been on an upward trend and that the profits have increased over the years. Essentially, it was observed that MFIs in Bahati Sub-County have generally grown in all fronts.

Inferential Analyses and Interpretations

In order to draw conclusions pertinent to the study objectives, it was deemed necessary to conduct inferential analyses on the data collected. Both Person's correlation and multiple regression analyses were carried out. Correlation analysis was aimed at establishing the relationship between each of the factors influencing MFIs' growth (that is, financial literacy and interest rates) and the growth itself. On the other hand, regression analysis sought to put into perspective the general influence of the aforestated factors on the growth of MFIs in Bahati Sub-County.

Relationship between Financial Literacy and Growth of MFIs

Relative to the first study objective, the study examined the influence of financial literacy on the growth of MFIs in Bahati Sub-County. Table 5 outlined how the two variables related.

Table 5: Correlation between financial literacy and growth of MFIs

		MFI Growth
Financial Literacy	Pearson Correlation	.919**
	Sig. (2-tailed)	.000
	n	41

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

The study findings indicated that there exists a strong, positive and statistically significant relationship between financial literacy and growth of MFIs ($r = 0.919$; $p < 0.01$).This implies that enhancement of financial literacy was very likely to boost the growth of these financial institutions and the reverse is true. The findings underscored the importance of ensuring that the employees of MFIs understand issues touching on finances. Employees should be enlightened regarding such aspects as credit advancement, credit appraisal, and loan recovery amongst other pertinent issues. This understanding is very likely to enhance the growth of MFIs.

Relationship between Interest Rates and Growth of MFIs

Moreover, the study examined the implication of interest rates charged by MFIs on credit facilities advanced to borrowers. Table 6 illustrated the results of the pertinent correlation analysis.

Table 6: Correlation between Interest Rates and Growth of MFIs

		MFI Growth
Interest rates	Pearson Correlation	-.147
	Sig. (2-tailed)	.361
	n	41

It was established that the relationship between interest rates and growth of MFIs was weak, negative and not statistically significant ($r = - 0.147$; $p > 0.05$).Interpretatively, interest rates were of minimal consequence on the growth of MFIs; and that they only negated the growth. That is by increasing the interest rates they charge on loans, there is a likelihood that there will be a number of prospective borrowers who will resist to take up credit facility. This would in turn reduce the growth of MFIs, however, with a small margin.

Influence of Financial Factors on the Growth of MFIs

Lastly, the study examined how financial factors (financial literacy, interest rates, and collateral) influence growth of MFIs in Bahati Sub-County. Table 7 shows a summary of the results of multiple regression analysis.

Table 7: Regression Analysis

Model	Un standardized Coefficients		Standardized Coefficients		
	B	Std. Error	Beta	t	Sig.
1 (Constant)	-1.142	.401		-2.848	.007
Financial Literacy	.978	.056	.952	17.473	.000
Interest rates	-.023	.060	-.026	-.382	.705

a. Dependent Variable: MFI Growth

Regression model: $Y= \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \varepsilon$

The model is interpreted as follows:

Growth of MFIs = -1.1142 + 0.978 financial literacy - 0.023 interest rates.

The regression analysis indicated that financial literacy had huge influence of the growth of MFIs. On the other hand, the findings revealed that the marginal influence of interest rates on the growth of MFIs was negative. Conclusively, it was found to be most important to emphasize on financial literacy amongst the employees of MFIs as one major way of enhancing the entities' growth.

SUMMARY

It was established that most of employees working with MFIs in Bahati Sub-County had been trained on matters of finances. The study indicated that financial literacy has improved deposit mobilization in MFIs. It was further observed that MFIs conduct financial literacy sessions for their staff; financial literacy enlightens employees on credit appraisal of prospective borrowers; financial literate employees are able to effectively recover debts borrowed by MFI customers; financial literacy has led to the increase in the number of customers at MFIs; and that financial literacy has improved the uptake of credit facilities in MFIs of in Bahati Sub-County. The study findings indicated that there exists a strong, positive and statistically significant relationship between financial literacy and growth of MFIs ($r = 0.919$; $p < 0.01$); a fact that underscored the importance of ensuring that the employees of MFIs understand issues touching on finances.

It was noted that MFIs generally charge higher interest rates than commercial banks; interest rates affect their growth; the interest rate levels influence the demand levels of credit facilities; the interest rates are determined by both external and internal factors but external factors have a greater influence; and that high interest rates partly contribute to default in loan repayment. It was established that the relationship between interest rates and growth of MFIs was weak, negative and not statistically significant ($r = -0.147$; $p > 0.05$). Needless to say, the findings underpinned the reason behind addressing the subject of interest rates cautiously.

The study indicated that MFIs in Bahati Sub-County have grown in many fronts. In this regard, it was revealed that MFIs have increased the number of their staff, MFIs have recorded increased number of account holders; the amounts of deposits have been increasing over the years; the amounts of loans borrowed have been on an upward trend and that the profits have increased over the years. It was observed that financial literacy is the most important determinant of growth of MFIs in Bahati Sub-County.

CONCLUSIONS

The study concluded that majority of employees with MFIs in Bahati Sub-County, Kenya were financially literate. This partly explained why financial literacy was so influential to the growth of MFIs in this sub-county. The study findings led to the conclusion that MFIs charge higher interest rates than mainstream commercial banks. More so, it was noted that external factors largely determined interest rates charged by MFIs. In the same breadth, it was inferred that high interest rates resulted in default in loan repayment. All these factors were deduced to negate the growth of MFIs.

RECOMMENDATIONS

The study recommends that MFIs should continuously enlighten their employees on financial matters. This can be ensured by organizing seminars, workshops, and conferences on finance for these staff. All new employees should be orientated on financial issues particular in line with microfinance immediately they are recruited. It is also recommended that MFIs ought to ensure that there is no huge disparity between the interest rates they charge and those ones charged by commercial banks and other lending institutions. This approach is bound to ensure that the MFIs will not lose out their customers to other competitors in the financial sector.

LIMITATIONS

Financial matters are usually treated with confidence as such as some respondents may be reluctant to disclose their financial information. Moreover, some MFIs were unwilling to disclose their loan portfolio in fear of the fact that it may be leaked to other competitors due to issues of client's financial privacy that may constitute breach of contract between them and their clients.

However, the researcher convinced the respondents in the letter of introduction that all matters were to be treated with confidentiality. There were instances of the lack of cooperation by the respondents and as such the researcher strived to convince the staff how the study was important and beneficial to them since it will help them to know about the challenges facing the community. If dealt with it would help them to expand their services to Bahati sub-County community.

SUGGESTIONS FOR FURTHER STUDIES

Authors, researchers and scholars are recommended to empirically study the various financial factors that influence the growth of firms in other areas such as Savings and Credit Cooperatives (SACCOs), commercial banks, microfinance banks. It is also suggested that it would be essential to conduct a comparative study on the growth of financial institutions that advance unsecure loans and those that give credit subject to the available collateral.

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