THE ROLE OF MICRO FINANCE INSTITUTIONS IN THE KENYAN ECONOMY: A CASE OF KISII TOWN, NYANZA

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Full Length Research

ABSTRACT

The objective of the study was to determine the role of micro fiancé institutions in the Kenyan Economy- a case of Kisii, Nyanza. The research used a survey method to assist the researcher achieve the objective of the study. The population of the study comprised of all operational Micro Finance Institutions registered in Kisii, Kenya. Convenient sampling technique was used to select the sample. The study also used, secondary data that was obtained from the financial statements of individual MFIs in Kisii. The results showed that profit before tax depended mainly on interest income, interest expense, shareholders funds, loans and advances to customers. Other significant determinants on profitability of microfinance institutions include provision for bad and doubtful debts and deposits & balances due from other financial institutions. The measures that were considered very important in determination of financial performance by the participants included operational costs, debt equity portfolio at risk and labour productivity. Financing costs was reported to be a major proportion of cost in the organization. The factors that were rated as highly significant by the respondents in determining financial sustainability include: repayment, average loan size, saving deposits and operational costs. Loan size, average size of saving deposits and number of branches were rated moderately significant in determination of financial stability which resulted to economic growth.

Key Words: micro finance institutions, Kenyan economy, Kisii town, Nyanza

INTRODUCTION

The World Bank defines Micro Finance Institutions (MFIs) as institutions that engage in relatively small financial transactions using various methodologies to serve low income households, micro enterprises, small scale farmers, and others who lack access to traditional banking services, CBS (1999). In another definition, the Microfinance Act, 2006, defines MFI as a business receiving money by way of deposits and interest on deposits which is lent to others or used to finance the business; or providing loans or other facilities to micro or small enterprises and low income households; deposit taking and non-deposit taking (MFI Act, 2006).

Financial intermediation is of great importance in any economy. Infact, in the Kenya's Poverty Reduction Strategy Paper (PRSP), the financial sector is expected to play a catalytic role in facilitating economic growth through SMEs (Dondo and Ongila 2006). Access to formal credit by small-scale entrepreneurs has been quite poor particularly among the low-income category. This is largely as a result of the credit policies associated with loans provided by the formal financial sector (Ringeera , 2003).

Profitability which has been defined as the capacity to make a profit or as a quality or state of being profitable is the matter at hand both as a measure of performance and a determinant of sustainability. Profitability is one of the most important indicators for measuring the success of a business. Maintained profitability leads to continued strengthening of the net worth and value to shareholders/owners of the organisation. Sustainability on the other hand is the ability of a firm

to continue its operations in the long term to ensure that a firm is not existing today and winding up tomorrow. . In some other context sustenance is the capacity of being maintained at a certain level. This calls for firm action, and professionalism in the running of an organization.

Sabana (2003) observed that by June 2003, there were an estimated 3,460 legally constituted microfinance service providers in Kenya, including 3,397 savings and credit co-operatives and co-operative like community based intermediaries, 56 MFIS, four commercial banks, two building societies and the Kenya Post Savings Bank. Excluded from this list were 17,305 rotating savings and credit associations (ROSCAs), 115,884 registered women groups and 1,342 primary agricultural producer and marketing cooperative societies, providing credit countrywide. There were approximately 3.8 million Kenyans depending on financial NGOS, Cooperatives and Kenya Post Office Savings Bank for financial services (Dondo and Ongila, 2006).

According to Dondo and Ongila (2006) Microfinance performance can take many forms depending on interest of the stakeholders. Different stakeholders require different performance indicators to enable them make informed decisions. The content, format and frequency of reports depend on who needs the information and for what purpose. For example shareholders will be more interested in profitability, growth, return on investment and continued financial stability of the institution (Situma, 1997). Governments and multilateral agencies are interested in expected social and economic benefits to micro entrepreneurs, such as increase in employment and income levels (Kesner, 2005). Recent years have seen a growing push for transparency in microfinance; this has seen an increasing use of financial and institutional indicators to measure both the risk and performance of MFIs (Yaron, 1994).

Inspite of the globally acknowledged role of MFIs in poverty reduction, there has been lack of globally acknowledged standards to rate their performance; instead, indicators tend to vary across regions. Abate et al. (2003) noted that in 2001 this led MicroRate, a rating agency specializing in microfinance, to invite other key players in the sector to agree on the definitions of a set of some commonly used indicators. Their intention was to give these indicators a common meaning. Their efforts led to publication of a list of 20 definitions of performance indictors. However, the fact that the sample included only Latin American institutions reduced its applicability when used in other regions of the world.

MicroRate was particularly interested in the applicability of the definitions in the African continent, where it has been working since the year 2000. The African Version of the "Technical Guide: performance indicators for MFIS" was developed for a workshop in Entebbe directed towards banking institutions interested in learning how to evaluate and measure the financial soundness of MFIs. (Abate et al., 2003).

Having successfully controlled the credit risk, microfinance institutions are now entering a new evolutionary phase as they become more responsive to the demands of the customers. To guarantee survival in the long term MFIs must engage in viable practices such as earning

profits/surpluses (sales revenue less costs).Tiwari and Fahad (2005) observed that Bangladesh produced the Grameen Bank Model, acclaimed in the developing world as a vehicle for poverty reduction and growth. It has an annual growth rate of 20% and a high recovery rate of loans of (98%). A still more interesting feature is the ingenious manner of advancing credit without any "collateral security. According to Mutua and Mirero (1985) in Kenya shortcomings in the provision of microfinance such as lack of a proper structure for loan disbursements and collection of repayments have reduced MFI performance in their ability to meet the objectives of achieving poverty reduction through growth and development.

STATEMENT OF THE PROBLEM

Microfinance ensures the provisions of financial services to the low-income households and micro and small enterprises (MSEs), provide an enormous potential to support the economic activities of the poor and thus contribute to poverty alleviation. Widespread experiences and research have shown the importance of savings and credit facilities for the poor and MSEs. This puts emphasis on the sound development of microfinance institutions as vital ingredients for investment, employment and economic growth.

The microfinance sector in Kenya has faced a number of constraints that need to be addressed to enable them to improve outreach and sustainability. The major impediment to the development of microfinance business in Kenya is lack of specific legislation and set of regulations to guide the operations of the microfinance sub-sector. Some of these forms or registrations do not address issues regarding ownership, governance, and accountability. They have also contributed to a large extent to the poor performance and eventual demise of many MFIs because of a lack of appropriate regulatory oversight. This has had a bearing on a number of other constraints faced by the industry, namely: diversity in institutional form, inadequate governance and management capacity, limited outreach, unhealthy competition, limited access to funds, unfavorable image and lack of performance standard. It has been estimated that formal microfinance bank only services less than one million clients in a country where over 60% of the country population of 40 million lives below poverty line (Irobi, 2008). It is therefore necessary to undertake an assessment of the micro financing as a strategic approach to new ventures and growth in Kenya. This is the overall objective of this study.

Hulme (1998) carried out a study on trade-off between reaching the very poor and having substantial impact on household income. He found that programmes that targeted higher-income households (those near the poverty level) had a greater impact on household income. Mosley (2001), in his research on microfinance and Poverty in Bolivia, assessed the impact of microfinance on poverty, through small sample surveys of four microfinance institutions. Nichols (2004) used a case study approach to investigate the impact of microfinance upon the lives of the poor in the rural China and found that the participation of poor in MFI program had led to positive impact in their life. Chijoriga (2000) evaluated the performance and financial sustainability of MFIs in Tanzania, in terms of the overall institutional and organizational

strength, client outreach, and operational and financial performance. In Kenya several studies has been done on microfinance institutions service, one of the researcher who have done research on MFI service Mushi (1997) examined the role of credit in generating entrepreneurial activities. However the studies did not address the role of micro finance institutions in the Kenyan economy

RESEARCH OBJECTIVES

The main objective of this study is to determine the role of micro finance institutions in the Kenyan economy, a case of Kisii Town, Nyanza

LITERATURE REVIEW

The Role of Microfinance in Economic Development

Microfinance is the supply of banking services to micro-enterprises and poor families. Access to services apparently brings along important social benefits for the clients (Littlefield, et al., 2003, Claessens and Feijen, 2006). Suppliers of microfinance are typically Non Governmental Organizations (NGOs), cooperative societies or specialized microfinance institutions incorporated as Shareholder Firms (SHFs). Microfinance Institutions (MFIs) in Kenya provide working capital loans in short loan cycles. It is evident that the bottom poor lack business opportunities and are therefore discriminated against in accessing financial services.

Microfinance provides benefits to micro-enterprises through various channels.Firstly, funds transfer facilities provided by microfinance institutions enable micro-enterprises to reduce the costs of handling payment transactions. This has positive implications for their profit levels. Secondly, the savings facilities provided by microfinance institutions enable micro enterprises to invest their surplus funds, while obtaining a return on their investments. This enables them to better manage liquidity and could increase their levels of self-financed investments. In addition, individual rights to these savings assets are legally recognized and can be used to meet collateral requirements.

Finally, the credit facilities provided by microfinance institutions enable micro enterprises to borrow funds to cover various short-term financial needs, such as working capital. These needs include financial costs incurred during pre-start-up training, planning and start-up phases in the micro-enterprise life cycle. Microfinance can also be used to cover the financial costs of further training and to meet other unforeseen circumstances (Robinson, 2003 and Mushendami, et al. 2004). The microfinance credit facilities enable micro-enterprise owners to use anticipated income from current investments. This reduces the vulnerability of the micro-enterprise to various shocks and stabilizes the income stream for the micro entrepreneur. The reduced vulnerability promotes the sustainability of the micro-enterprise at its existing levels, to the extent that this credit is used to acquire capital (physical or human), which yields a rate of return

in excess of the cost of credit. Furthermore, microfinance enhances the income of micro entrepreneurs and increases the chances that they will diversify or expand their activities.

Access to Finance in Kenya

The government of Kenya recognizes that greater access to and sustainable flow of credit to the informal financial sector operations is critical to good progress in poverty reduction. The government therefore, channels financial assistance to SMEs through reputable MFIs and other financial institutions in an effort to reduce poverty (Kitaka, 2001). In Kenya, donors such as USAID have been at the forefront in providing finances to MFIs, as is the case of K-REP. On the other hand commercial banks have also been involved in the provision of funds to the MFIs. According to CBK Report (2000), Commercial banks provide financial services to MFIs with the aim of assisting them to reach the SMEs. Kitaka (2001) observed that some well established banks have come up with sections which support MFIs, as in the case of Barclays Bank-Small Business Loan and KCB Special Loan Scheme as some of the examples.

According to Kitaka (2001), self-help groups also provide finances to SMEs through savings. They initiate and start an income-generating venture from which they save the surplus funds with the MFI of their choice. These savings become a source of funds to the MFI, which it in turn lends out at an interest. (Kitaka; 2001). Oikocredit, a Holland based Christian Institution, has proved itself to be the single largest Credit provider for the needy MFIS and individuals in Kenya and currently has advanced a total loan portfolio amounting to 2.5 billion shillings (ranging from the sum of 4.5 million to 180 million shillings). The aim of Oikocredit is to empower Institutions which have for long suffered from non-availability of formal credit from Banks due to lack of collateral. This organisation lends through intermediaries to cut down on running costs and achieve its objectives.

Microfinance Institutions Performance

Profitability indicators such as return on equity and return on assets, tend to summarize performance in all areas of the company. If portfolio quality is poor or efficiency is low, this will be reflected in profitability. Since there are so many factors, profitability indicators can be difficult to interpret. The fact that an MFI has a high return on equity says little about why that is so. All performance indicators tend to be of limited use (in fact, they can be outright misleading) if looked at in isolation and this is particularly the case for profitability indicators. To understand how an institution achieves its profits (or losses), the analysis also has to take into account other indicators that illuminate the operational performance of the institution, such as operational efficiency and portfolio quality.

Key determinants of success for MFIs include management's abilities to understand movement in interest rates and inflation and to interpret forecast with regard to interest rates, concentration of Mfis in a particular location, competition among Mfis in providing a specificialised service, the total assets the organization owns and the potential of such assets to contribute to profits, the

market share of an institution, the magnitude of wages/ the wage inflation rate and the price-cost margins in the services being delivered, the managerial efficiency and in the primary purpose of the MFI for instance in providing basic needs to the very poor people in the slum/ rural areas While all managers must respond to interest rate changes, growing globalisation of financial markets creates additional such as making assets/liability decision in relation to changes in the value of the currency in use against other currencies (Kibe, 2003).

Rwanda's scenario of a record 200 MFIs emerging after the 1994 and the deregistration of 8 in 2004 due to failure to follow the laws regulating such institutions proves that guaranteed existence of MFIs requires serious guarding and intensive searching for long term financial survival. Management of MFIs need to be prepared to overcome the hurdles of withdrawn donor funding as well as squeezed funding/financing. African's MFIs especially in Uganda are drawn to commercialisation of the sector. Lakwo (2006) has reflected that the aim of most African MFIs is to reach as many people as possible in order to give them economic empowerment owing to rising poverty levels.

Analysis of profitability is further complicated by the fact that a significant number of MFIs still receive grants and subsidized loans. Withdrawal of such subsidies/donations may render the institution a failure unless such an institution is a well grounded in other forms of funding. Creative accounting can also have an astonishing impact on profits. Relatively few MFIs are regulated and it would be easy to achieve a dramatic change in their profitability through the simple expedience of adjusting the level of loan loss reserves and other manipulations of financial statements.

Among the most difficult situations facing financial institutions is the existence of uncertainty regarding their inflows which are mainly constituted by their deposits (Baltensperger and Milde, 1976). The financing institution does not know in advance exactly what inflows and outflows it will experience in its deposit accounts. Okutoyi (1988) observed that banks consistently compete for deposits as public confidence in the financial system keeps on being patronized. This point is further underscored by Channon (1986), who pointed out that as a result of the growing competition and rapid change more and more financing institutions worldwide are increasing their strategic planning efforts aimed at gaining competitive advantage.

Effectiveness/performance of MFIs can be measured by the number of poor people the institution has managed to feed, the number of women it has empowered, the youth projects started and whether the MFI has utilized the budgeted funds or such funds have been properly disbursed to the targeted groups. Profitability is a particularly unique characteristic in assessing a particular Mfi since when the MFI realizes profits (the residue of costs deducted from revenue), it gives a guarantee that the institution is not under threat of bankruptcy and getting wound up by the Government. Instead, the institution expands and grows to reach more people in offering the services it was meant to provide efficiently socially and economically.

Determinants of the profitability and Sustainability of MFIs

Interest Rates

The interest rate is the price one pays for using borrowed money (loans). In money- monetary economies, money creates claims because it is an asset, a store of value, as well as a medium of exchange. Therefore those who lend money expect to be compensated for handing over their claims for the period of the loans to those who borrow money. This interest rate also covers the exposure to credit risk by lenders Therefore interest rate can be defined as the price lenders expect (and borrowers pay) for exchanging current claims for greater future claims to goods and services. Interest rates represent the cost of money (Kimutai, 2003).

Margarida (2000) found that net interest margin reacts positively to operating costs and hence profitability. Guru and Shanmugan (1999) stated that changing market conditions would also have an impact on the market interest rates which would certainly have a direct impact on profitability. The overall objective of a MFI should be to balance its return and risk in a way that maximizes the MFI market value to its owners, Hompel (1994). Relating this objective to interest rates, a bank should try to earn the highest margin it can in a manner consistent with reasonable stability in the interest margin. Sinkey (1992) notes that the business of banking involves betting on interest rates while Ritter et al (1997) suggested that the success or failure of an MFI depends on how well the Institution buys and sells money.

Non-Interest Income

Non-interest sources of commercial banks income include service charges on deposits and income from various non-deposit activities (Kibe, 2003). Bank charges are the payments debited to a bank account for the services the bank provides. They include, charges on opening of accounts, bankers cheque processing, salary processing, loan processing, on telex services, commissions and account closing. With the declining interest rates in Kenya, banks have sought to maintain their levels of profits by increasing bank charges. The relationship between this action and profitability is not obvious as this may make their products unattractive.

According to the Market Intelligence Banking Survey (2003), whereas fees and commissions are increasingly becoming a burden to depositors, Kenyan banks are looking at it as a growth area following the decline in interest earnings and fears of interest rates regulation. This strategy by Kenyan commercial banks has seen fees and commissions income progressively grow from Ksh9.9 billion in 1999 to Kshs 14 billion in 2002, a 38% growth. Kibe (2003) noted in relation to non-interest income established that interest rate spread accounts for 40% of total variations in profits of commercial banks. This means that 60% of variations are due to other factors that do not relate to interest rates. He concluded that interest rate spread not contribute significantly to the profitability of commercial banks as less than 20% of profits can be explained by interest rate spread leaving 80% to non-interest related factors. He recommended that further research be done to determine the other factors that affect profitability in banks. This applies to MFIs too.

Non–Interest Expenses

The relationship between expenditure and profits may appear to be very straightforward. The lower the expenditure, the higher the profit, income remaining constant. This may not necessarily be so, however especially if higher expenditure is associated with higher volume of business activity and hence higher revenues. Thus, in order to assess a bank's profits, total expenditure would be deflated by total assets to measure the firms specific expense management efficiency by measuring the cost incurred per monetary unit of assets. Dermirgue –Kunt (1999), in their research on bank profitability found that the difference in the mix of bank activity has an impact on spreads and profitability. Margarida and Mendes (2000), in their research found that the net interest margin reacts positively to operating costs, but pre-tax profit does not. This means that less efficient banks charge higher interest rates on loans (or pay lower rates on deposits), therefore passing those costs onto customers.

In their study on Malaysian banks, Guru and Shanmugn (1999) divided the profitability determinants into two main categories, namely the internal determinants and the external determinants. The internal determinants included management controllable factors such as liquidity, capital adequacy, asset and liability portfolio management and expenses management. On the other hand external determinants included those factors, which are beyond the control of the management of these institutions such as ownership, firm size and external economic conditions such as inflation rates, market interest rates, competition, MFI concentration, regulatory conditions and market growth.

Asset Composition

Dermirgue-Kunt (1999), in their research on bank profitability found that with bank relatively high non-interest earning assets are less profitable. Margaridat and Mendes (2000) found that the loan-to-asset ratio has a positive impact on interest margins and profitability. Guru and Shanmugan (1999) found that in relation to asset portfolios, the commercial banks should focus on loans rather than investment in securities and investment in subsidiaries where they lack the necessary business expertise in order to improve their profit performance. Davaajargal (2000), in his research found the correlation between performing loans and profitability to be negative and statistically significant. He also found that loans outstanding was one of the factors determining bank profitability, hence banks need to increase their lending. He concluded that due to the weak legal environment, loan repayment is very poor, which increases non-performing loans.

Deposit Composition

Ochung (1999) investigated whether there existed any relationship between deposit portfolio and profitability in public quoted banks and financial institutions in Kenya. His study indicated a significant correlation between deposit portfolio and profitability of the firms. He emphasized sound investment of deposit funds in the realization of profit. Dermirgue-Kunt (1999) in their

findings concluded that banks that rely largely on deposits for their funding are also less profitable, because deposits entail high branching and other expenses. Further, variation in overheads and other operating costs are reflected in variations in bank interest margins. Davaajargal (2000), in his research found that correlation between current accounts of business entities, government accounts and bank profitability is strongly negative. He concluded that banks do not need to hold large amounts in current accounts of business entities, individuals and government because they bear none or little interest. He recommends that banks should however stop paying interest on the unmoving balance of current accounts in order to attract customers.

Liquidity

In terms of liquidity management, banks involved in the business of transforming short-term deposits to long-term credit would be constantly faced with risks associated with the maturity mismatch. In order to hedge against liquidity deficits, which can lead to insolvency problems, banks often hold liquid assets, which can be easily converted into cash. However, liquid assets are often associated with lower rates of return. Hence high liquidity would be expected to be associated with lower profitability. Consistent with the foregoing argument, Molyneux and Thornton (1992) have found a weak inverse relationship between liquidity and bank profitability. However, Bourkes (1989) result has indicated a significant positive relationship between liquidity and bank profitability. One possible reason for the conflict in the findings may be different elasticity of demand for loans in the two varying samples. Guru and Shanmugan (1999), in their report concluded that commercial banks should not over commit in loans, since the liquidity variable as measured by the loans to deposit ratio was generally found to have a negative impact on bank profitability.

Product Differentiation

Thompson and Strickland (1993) define this competitive strategy as seeking to differentiate the company's product offerings from rivals in ways that would appeal to a broad range of buyers. The value of differentiation commands a premium price. In differentiation there is perceived quality and signals of value, whether real or not. The advantage of a differentiation strategy is that the perceived quality insulates a company from threats from many of the five forces that determine the state of competition in an industry. Successful differentiation is based on a study of buyers' needs and behaviour in order to learn what they consider important and valuable. The desired features are then incorporated into the product to encourage buyer preference for the product. The basis for competitive advantage is a product whose attributes differ significantly from rivals' products. Competitive advantage occurs when buyers become strongly attached to these incorporated attributes and this allows the firm to charge a premium price for its products, benefit from more sales as more buyers choose the product, more borrowers become attached to the differentiating features resulting in greater loyalty to its brand. Efforts to differentiate often result in higher costs. Profitable differentiation is achieved by either keeping the cost of differentiation below the price premium that the differentiating features command, or by

offsetting the lower profit margins through more sales volumes. With an ideal combination of the factors above, the profitability of the MFI is guaranteed and may well be sustained through professional management.

RESEARCH METHODOLOGY

The research used a survey design. Mugenda and Mugenda, (1999) stated that the descriptive survey is a method that will collect data from the population and help the researcher to get the descriptive existing phenomena. The population of the study comprised of all the Micro finance institutions in Kisii town. The list of these microfinance institutions is provided in the appendix. This was obtained from the Central Bank of Kenya annual Report on Microfinance Institution in Kenya and the Association of Microfinance Institutions (AMFI). The convenient sampling technique was used. The main features of this method are the fact that subjects are easily and conveniently available, have been operating for the last five years and are located in Kisii town. The sample size for the study was fifteen MFIs in Kisii town. Primary data was obtained in form of questionnaires to financial managers in the Microfinance institutions involved in the study while secondary data was obtained from the financial statements of individual MFIs in Nairobi area. This was supplemented with other data from various government publications such as central bank of Kenya publications (Annual Bank supervision Reports) and the central bureau of statistics data (CBK, 2006). The descriptive and statistical analysis was used basing on data and information collected from primary sources. Quantitative data was generated and analyzed through questionnaires. The information was analysed on MFIs included general profile, clients' outreach and the market, product and services provided, impact assessment, and future plan and constraints. On the side of MSEs, the issues analysed included general profile, types of services received from MFIs, conditions for service accessibility, and future plan and constraints for growth. Data was presented in the form of frequencies, percentages cross tabulation and correlation analysis, so as to establish the relationship of variables. Correlation analysis was done in order to test some of the assertions raised. Correlation coefficient was used to quantify the strength of association between the variables as well as testing the significance of relationships. This section is divided into two parts.

Conceptual Model

The relationship between profitability and its determinants is summarised below:

P = f (ii, ie, pd, db, la, sf,) ....**(1)**
Where:

       P = Profit before tax
       ii = Interest income
       ie = Interest expense
       pd =Provision for bad and doubtful debts
       db =Deposits and other bank balances

la = Loans and advances

sf = Shareholders funds

Analytical model

The following analytical model was applied in this study:

$$Pbt = k + \alpha_1 ii + \alpha_2 ie + \alpha_3 pd + \alpha_4 db + \alpha_5 la + \alpha_6 sf + e_t \text{...(2)}$$

Profit before tax is measured by an institution's operating results before subjecting these to corporate tax. We expect to have a positive relationship between the dependent variable, profit before tax, and interest income, debts and other advances as well as loans and balances from other banks and shareholders' funds. A negative relationship is on the other hand expected between the dependent variable and interest expense, provision for bad and doubtful debts. Interest income is measured by applying the interest rate charged on the loans/advances granted to customers and the length of time the amount is owed to the lenders. Interest expense is calculated as the cost of lending money to the loanees; interest rate charged on the loans. Provision on bad and doubtful debts is dependent on the policy of an institution's accounts receivable and impacts on profitability of an MFI. Shareholder's Funds is basically the residual of the Company's profit which belongs to shareholders/owners. This is a crucial area of showing how much money the MFI may retain for its growth and expansion this will as well show the rate of GDP growth.

RESEARCH RESULTS

Table 1: Summary of Statistics

	Mean	Std. Deviation	Variance	Skewness	Kurtosis
	'000"	'000"	'000"	Statistic	Statistic
Profit before tax	573207.1	824374.2	6.8E+11	1.534236	1.184138
Interest income	1066627	1823417	3.32E+12	1.71594	1.727111
Interest expense	185776.9	369319.4	1.36E+11	1.995356	2.710062
Provision for bad debts	154773.5	394509.3	1.56E+11	2.911923	8.455814
Deposits and balances due from other banks	347304.4	664928.6	4.42E+11	2.271045	4.889763
Loans and advances to customers	5026290	11028777	1.22E+14	2.513595	6.127754
Shareholders funds	2127190	4100281	1.68E+13	2.56902	6.923646

Table 1 provides a summary of descriptive statistics. It can be seen that profit before tax had an average value of 573 million for all the companies surveyed. Standard deviation measures the

dispersion from the mean and Loans and advances to customers had the highest standard deviation. Loans and advances too had the highest variance. Skewness characterizes the degree of asymmetry of a distribution around its mean. Positive skewness indicates a distribution with an asymmetric tail extending toward more positive values. In this case shareholders' funds reported the highest level of skewness while profit before tax reported the lowest level of skewness.

Kurtosis characterizes the relative peakedness or flatness of a distribution compared with the normal distribution. Positive kurtosis indicates a relatively peaked distribution. All the factors determining profitability of MFIs were peaked with provision for bad debts reporting the highest level of peakedness and profit before tax reporting the least peakedness.

Results of Correlation Analysis

Table 2 shows the results of the correlation tests for the various variables influencing profits of MFIs. The table illustrates that there was a high correlation between profit before and interest income, interest income, loans and advancement to customers and interest expense in that order. Interest expense and interest expense were highly related to each other while provision for bad debts and deposits and balances due from other banks were also highly related to each other. Loans and advances to customers as well as shareholders funds were found to be highly related to profit before tax.

Table 2: Correlations for Factors Affecting Profitability of MFIs

	Profit before tax	Interest income	Interest expense	Provision for bad debts	Deposits and balances due from other banks	Loans and advances to customers	Share-holders funds
Profit before tax	1.000	.894	.798	.504	.434	.892	.894
Interest income	.894	1.000	.971	.794	.760	.829	.762
Interest expense	.798	.971	1.000	.900	.859	.696	.673
Provision for bad debts	.504	.794	.900	1.000	.941	.350	.353
Deposits and balances due from other banks	.434	.760	.859	.941	1.000	.344	.305
Loans and advances to customers	.892	.829	.696	.350	.344	1.000	.740
Shareholders funds	.894	.762	.673	.353	.305	.740	1.000

Results of Regression Analysis

In this section regression analysis was carried out to determine the strength and the nature of the relationship between profit before tax and the factors affecting it.

Table 3: Significance Tests for Factors Affecting Profitability of MFIs

	Profit before tax	Interest income	Interest expense	Provision for bad debts	Deposits and balances due from other banks	Loans and advances to customers	Share-holders funds
Profit before tax	.	.000	.000	.028	.053	.000	.000
Interest income	.000	.	.000	.000	.001	.000	.000
Interest expense	.000	.000	.	.000	.000	.002	.003
Provision for bad debts	.028	.000	.000	.	.000	.101	.099
Deposits and balances due from other banks	.053	.001	.000	.000	.	.105	.134
Loans and advances to customers	.000	.000	.002	.101	.105	.	.001
Shareholders funds	.000	.000	.003	.099	.134	.001	.

The criteria for determining the level of significance for a one tailed test was taken as less than 0.05 being significant while greater than 0.05 as being insignificant. From the above table we can see that interest income, interest expense, loans and advances to customers and share holders funds are highly significant in determining profit before tax. Provision for bad debts was found to be significant even though not to a high level as the aforementioned four factors. On the other hand Deposits and balances due from other banks were found to be insignificant in determining profit before tax. In the same measure it can be seen that interest income and interest income had all the other factors significant in determining its composition. It was also found out that there was no significant relationship between provision for bad debts and loans and advances to customers as well as with shareholders funds. There was also an insignificant relationship between deposits and balances due from other banks with shareholders funds.

Table 4: Regression Tests Summary

R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
				R Square Change	F Change	df1	df2	Sig. F Change
.977(a)	.955	.931	217026.417	.955	38.600	5	9	.000

a   Predictors: (Constant), Shareholders funds, Deposits and balances due from other banks, Loans and advances to customers , Provision for bad debts, Interest expense

Table 4 provides a summary for the regressions model utilized in the study. It can be seen that there is a high relationship between profit before tax with shareholders funds, deposits and balances due from other banks, loans and advances to customers, provision for bad debts, interest

income and interest expense. The adjusted coefficient of determination that 93.1% of the variation in profit before tax is explained by interest income, interest expense, deposits and balances due other banks Shareholders funds, Loans and advances to customers and Provision for bad debts. The F statistic also confirms the significance of the relationship.

Table 5: Coefficients of Determinants of Performance in MFIs

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	142868.228	77256.371		1.849	.097
Interest income	-.220(a)	0.073	-.009	3.025	.981
Interest expense	-2.233	2.214	-1.000	-1.009	.340
Provision for bad debts	2.242	1.361	1.073	-1.647	.134
Deposits and balances due from other banks	-.235	.296	-.190	-.795	.447
Loans and advances to customers	.059	.023	.787	2.585	.029
Shareholders funds	.134	.047	.664	2.866	.019

a Dependent Variable: Profit before tax

Table 6 shows the coefficients for the regression model. The t-test determines the strength of the relationship between profit before tax and the other variables. In determining the strength of the relationship between profit before tax and the other variables we see that interest income, shareholders' funds, loans and advances to customers and provision for bad debts are stronger in that order in determining profit before tax. The interest income figure against profit before is 3.025 followed by that of shareholders funds at 2.866. Deposits and balances due from other banks and interest expense scored lowly at a t statistic value of -0.795 and -1.009 respectively.

CONCLUSIONS

Microfinance institutions are very crucial in the supply of banking services to micro-enterprises and poor families. Suppliers of microfinance are typically Non Governmental Organizations (NGOs), cooperatives or specialized microfinance institutions incorporated as Shareholder Firms (SHFs). Recent developments in the microfinance industry both in Kenya and elsewhere have involved the transformation of MFIs into banks or other forms of regulated institutions. However for this transformation to occur, the MFI have to show that they have a potential to be profitable and a capacity to compete with other established institutions in the banking sector. Profitability has evidently been one of the most important underlying elements seducing capital in the long run. MFIs are moving more and more towards profitable areas seeking the best returns related to the amount/level of risk their stockholders are willing to bear. It is important that sufficient profits are generated by MFIs so as to allow for dividends to be paid to shareholders, and if

possible, for some funds to be ploughed back into the business in order to finance further growth. As the environment in which microfinance institutions change so is the need by management to ensure that they fit in to the environment they move. As the market of MFIs increase more will be placed upon them to ensure their performance improves. Performance can only improve if managers know their current status. There is need to ensure that accounts are kept properly so that these managers can know specific areas that needs improvement.

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