

**COMPETITIVENESS OF INTEREST RATES CHARGED BY
MICROFINANCE INSTITUTION IN MIGORI COUNTY - KENYA**

BY

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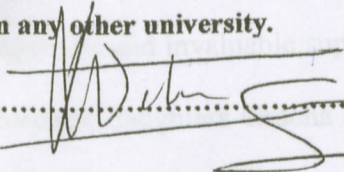
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DECLARATION

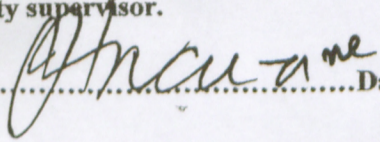
This management research project is my original work and has not been presented for award of a degree in any other university.

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ABBREVIATIONS

AMFI	Association of Microfinance Institutions
B.C.	Before Christ
BKD	Bank Credit Desa of Indonesia
BRAC	Bangladesh Rural Advancement Committee
CBK	Central Bank of Kenya
DFID	Department of International Development (UK)
KADET	Kenya Agency for the Development of Enterprise and Technology
KWFT	Kenya Women Finance Trust
MFIs	Micro Finance Institutions
M-PESA	M for Mobile PESA – Swahili word to money
MSMES	Micro Small and Medium Term Enterprises
NGOs	Non Governmental Organizations
PPPCR	Burkina faso le project du petit credit Rural
ROSCAS	Rotating Savings and Credit Associations
SACCOS	Credit Cooperative Societies
SI	Share In
SMEP	Small and Micro Enterprises Programme
U.K.	United Kingdome
U.S.	United States
UNDP	United Nations Development Programme

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ABSTRACT

Microfinance is touted as the solution to the wide spread poverty in most developing countries, however, some people have been wondering how MFIs can fulfill their social obligations while charging their clients interest rates that are higher than those offered by non-microfinance institutions such as traditional commercial banks. This study tries to establish the interest rates charged by microfinance institutions in Migori County and to identify the impact of interest rate differences on borrowing by small scale traders. Questionnaires were distributed to be filled in by branch managers or credit officers in respective financial institutions, the content of the questionnaires were analyzed and presented in relation to the objectives of the study. The findings show that the interest rates charged by MFIs vary with a range of almost 20% and that on average MFIs charge higher interest rates than mainstream commercial banks. It was also found that MFIs that charge lower interest rates have a bigger customer base going by their branch network and patronage.

THE ADVANTAGE

CONCLUSION

THE ADVANTAGE OF GOOD MICRO FINANCING PROGRAMME

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CHAPTER ONE

INTRODUCTION

1.0 Introduction

This chapter gives an overview of the study. A background of the study is given which brings out the Research Problem, Research Objectives are clearly stated and so is the Significance of the Study.

1.1 Background of the Study

The interest rates charged on micro credit is one of the most discussed issues in micro finance, capturing the attention of both, the media and the industry analysts, while, micro finances is scrutinized as a tool for providing credit in developing countries interests rates have once again captured public interests and alternative models for looking at interests rates and operating costs have received renewed attention. At the heart of discussion is how micro finance institutions (MFIs) can fulfill their social obligations while charging their clients interest rates that are higher than those offered by non microfinance financial institutions such as traditional commercial banks (Mohammed Yunus, 2010).

Interest charged on loans is the main source of income for MFIs, thus they must be high enough to cover operational costs (Fernado 2006). Since micro lending remains a high cost operation interest rates remain high, Fernando reports that MFIs in the Asia pacific region charges interests between 30 to 70% a year. Still there is much to be gained through lower micro credit interest rates, the current high costs means micro credit efforts are not reaching as many people as they could. Lower micro credit interest rates will increase the depth and breadth of availability of affordable finance for poor households (Fernado 2006).

1.1.1 Competitiveness of Interest Rates

Competitive interest rates can lead a micro finance institution to have a competitive edge over rivals. Sources of competitive advantage include high quality products, superior customer service and achieving lower costs than rivals (Porter, 1980) the microfinance organizations operating in Kenya are characterized by limited resources, therefore. It is very important to focus on gaining competitive advantage to enable them respond to and compete effectively in the market. Interest rates are a measure of a price paid by the “borrower” (or debtors) to a lender (or creditor) for the use of resources during some time interval. The sum transferred from the lender to the borrower is referred to as the principal and the price paid for the use is usually expressed as a percentage of the principal per unit of time (Fabozzi and Modigliani, 1992). The transfer from savers to investors occurs through a variety of financial instruments, and the price paid may differ between instruments. Indeed at any one time, a bewildering array of rates is offered on different instruments. Real interest rate encompasses transportation cost to the borrowers, insurance charges on loans advanced, adjustment for inflation plus nominal interest rates.

Interest rates play a central role in all our lives. They are the cost of borrowing, for those of us who need resources and the reward for lending to those of us with savings. Higher interest rates tend to restrict growth of credit, making it harder for businesses to get financing and for individuals to find or keep jobs (Geccheta, 2008). Most people respond to low interest rates by borrowing and spending more, individuals take out loans to purchase cars, new appliances and the like, while corporations issue more bonds and use the proceeds to enlarge their operations, small businesses also take out loans to expand their businesses. Conversely when interest rates rise people borrow and spend less, therefore interest rate volatility makes output unstable.

Persistent poverty and overcoming low levels of social and economic development around the world are the greatest challenges facing the developing countries. Consequently, the issue of financial inclusion has emerged as a policy concern primarily to ensure provision of credit to small and medium enterprises that are normally denied access to credit by mainstream financial institutions and markets. The emerging

microfinance revolution with appropriate designed financial products and services enable the poor to expand and diversify their economic activities, increase their incomes and improve their social well being (Ledgerwood, 1999) microfinance institutions (MFIs) exist to serve this need.

1.1.2 Microfinance

World Bank defines MicroFinance 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 micro finance Act, 2006 defines MFIs as 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).

Microfinance is closely related to the real economy. It is about lending money to the poor in order to help them get out of poverty (Mohammed Yunnus, 2010). Microfinance services can help low income people reduce risk, improve management, raise productivity, obtain higher returns on investment, increase their income and improve the quality of their lives and those of dependants. The beneficiaries are often individuals who lack collateral steady employment and verifiable credit history and therefore cannot meet even the most minimal qualifications to gain access to traditional credit.

Microfinance is not a recent development and neither is the development of regulation and supervision of micro finance institutions (MFIS). Every new developed country has its own history of microfinance. Attributing the origin of microfinance to recent initiatives misses not only the historical depth and scale of micro finance but also centuries of experience. The precedence for microfinance lies in the many traditional and informal systems of credit that have existed in developed economies for centuries. Many of the current practices are derived from community based mutual credit transactions that were based on trust, peer bases, non-collateral, borrowing and repayment transactional, mutual or personal credit suppliers such as money lenders, rotating savings and credit

associations or friends and neighbours have always lent to the poor providing the right quantity and quality of credit (Remenyi 2007). The most famous of the micro finance institutions are the Grameen Bank and the Bangladesh Rural Advancement Committee (BRAC) which were both established in 1970s as pilot projects. Both were later formalized in early 1980s with Grameen Bank becoming a private sector bank with a limited license and BRAC becoming a non governmental organization (NGO). These two institutions have had global influence as there have been many successful attempts to replicating them in other developing countries (Remenyi, 1997).

The micro finance Act 2006 which came into effect on 2nd May 2008, set out the legal, regulatory and supervisory framework for the micro finance industry, so far several regulations have been issued under the Act for deposit taking business, however the regulations to govern the conduct of the non deposit taking micro finance business are yet to be put in place, under the Act. The central bank of Kenya, is mandated to issue licenses to deposit taking micro finance institutions which have fulfilled all the requirements.

Micro finance provides access to financial services that can help to reduce poverty by both promoting opportunities and facilitating empowerment. However access is hindered by high interest rates, complicated application procedures and long admissions. (World Bank, 2010). Commercial banks and other formal financial institutions, however fail to cater for the credit needs of self employed persons, mainly due to their lending terms and conditions. They require collateral, which the poor find difficult to provide. The financial institution prefers handling large loans than the small ones needed by the poor and their loan application procedures are too cumbersome for the poor. It is mainly such rates and regulations of the formal financial institutions, which have created myths that the poor are not bankable and since they cannot afford the required collateral, they are not considered credit worthy (Adera, 1995).

Ownership structure of specialized MFIs is distinct from that of conventional financial institutions, the latter have individuals and profit minded institutional shareholders with deep pockets who can offer additional capital in a time of crisis and who push the

institutions to perform optimally, in contrast a specialized microfinance institutions is usually majority owned by NGOs, typically this NGO cannot easily be counted in for significance financial support at a time of crisis and it might not prioritize efficiently or sustain ably, since it is based more on social purpose than on profit motive, clients of micro finance are low income entrepreneurs with rudimentary family businesses and limited formal documentation as such they are regarded usually as high risk borrowers. Loans of MFIs are typically smaller, shorter term and carry higher interest rates, as a result the loan portfolio of micro finance institutions have higher risk profile it is more atomized which decreases risk but has higher turnover which again increases risk. The MFIs lending methodology is distinct from others of conventional financial institutions. Character and cash flow analysis plays a greater role, while the use of collateral and formal documentation plays a lesser one. Repayments are made weekly by weekly installments rather than monthly which results in higher administration costs. (Murdoch, 2002).

1.1.3 Migori county

Migori County is in the former Nyanza province located in South Western Kenya with its capital in Migori Town, it boards Homabay, Kisii and Narok Counties, 2009 census indicated that it had a population of 1028579 spread over an area of 2592km² of which 475km² is composed of lake Victoria, the county is inhabited by the Luo and Kuria tribes. Migori county boards Tanzania at Isibania spreading to Muhuru Bay and Uganda inside lake Victoria around Migingo Island. The economic mainstay of Migori County include Tobacco farming, Sugar Cane Farming, Fishing in lake Victoria, maize farming and gold mining in Kehancha town and Macalder in Kuria and Nyatike constituencies respectively. Migori county consists of Rongo, Uriri, Migori, Kuria and Nyatike Constituencies which are currently sub divided into seven administrative districts. 58% of the County population live in absolute poverty while 51% experience food poverty level (Republic of Kenya, Central Bureau of Statistics, 2003).

Migori County has tarmac length of 72 km while all the remaining roads are murrum, piped water and most essential infrastructure are scarce in Migori county making doing business and accessing loans or financial services expensive. Micro finance institutions are spread all over the county with Kenya women Finance Trust (KWFT) leading the pack with a large branch network in all major centres, there are also, Adok Timo, Faulu Kenya, Tangaza, SMEP, Move On, Kadet among others mostly found at the county headquarters. The region is also served with several bank branches including Kenya Commercial Bank, Post Bank, Barclays, Cooperative Bank, National Bank and Equity Bank. Because the area relies heavily on agriculture, there was Agricultural Finance Cooperation (AFC) which is now defunct which served farmers in the 1980s and 1990s. (District Trades Office, Migori District, 2011).

1.2 Statement of the Problem

Micro finance institutions in Kenya play a significant role in the growth of the Kenyan economy. As the economy continues to grow there is an obvious need to expand business transactions to all categories of people living in Kenya, it must be realized that the poor contribute a great deal to the positive or negative economic influences. The informal sector is estimated to comprise 6.4 million people. Interest income generally constitutes the major income for both micro finance institutions and commercial banks. Analysts agree that interest rates determine the entire earnings of the banking sector, whose core source of income is interest income (CBK 2010). Even though managers of micro finance institutions may have very little control over the interest rates charged in the market place, there are other conscious decisions they make that could reduce the impact of high interest rates on their clients.

Most of the Kenya's people are poor and majority of Kenya's poor are women, most poor people are self employed or work in micro and small businesses, if poverty is to be reduced and if the economic potential of the majority is to be realized the economic activities of poor people need to be financed (AMFI, 2005). This is the reason why micro credit needs to be made affordable for the poor to access. Many people who borrow through the micro finance institutions located in rural areas are either semi illiterate or

They do not understand completely the working of micro finance institution. This has made it difficult for them to understand how interest and other charges are arrived at. There is also a perception created in the rural areas more so among the poor that banks are expensive and do not lend money to the poor. This has been so to the extent that the poor have failed to take up new innovative products offered by banks such as Equity to expand their business.

1.4 Importance of the Study in Theory and Practice

Several studies have been carried out in this field but they have all focused on different issues. Gathoni (2010) carried out a survey to find out challenges to the growth and development of micro finance institutions in Kenya and found that factors affecting the growth and development of micro finance businesses can be grouped into two broad categories namely institutional-based factors and client based factors but was not able to assess the appropriateness of various lending methodologies applied by MFIs. Wahid (1994) found out that the loan recovery rates with graduated 'borrowers' (those who are engaged in taking second or more loans) is relatively lower than the new borrowers which shows that the 'graduated borrowers' would have successfully lifted themselves above the poverty line but there is lack of innovative appealing economic activity hence a sense of disillusionment and subsequently under performance. A study carried out by Fowler and Kinyanjui (2004) found out that the neglect of the poor may be attributed to the fact that tiny loans required by the poorest people may be too small to generate significant interest for lenders and are expensive to deliver especially in sparsely populated rural areas.

As far as I am concerned no related research has been carried out in Migori County to establish the competitiveness of interest rates charged by micro finance institutions. This study intends to add to the literature by assessing the impact of varying interest rates charged by micro finance institutions on choices made by borrowers and whether the alternative financial institutions like banks offer better rates. Migori County is chosen because of its varied economic activities, heavy presence of NGO run micro finance institutions and high poverty levels which pervades all corners of the county.

1.3 Objectives of the Study

1. To ascertain the interest rates charged on loans advanced by microcredit institutions in Migori County.
2. To identify the impact of interest rate differences on borrowing by small scale traders.

1.4 Importance of the Study to Theory and Practice

The government through this study will be able to establish a regulatory framework to guide the micro finance institutions on interest rates to charge and to weed out exploitative institutions like the pyramid schemes. This study will also enable the microfinance institutions to redesign their credit structure to suit their customer needs and to avoid wasteful procedures that add cost to credit.

Borrowers will be empowered through this study to make informed decisions while sourcing for credit from micro finance institution scholars and academicians will also find this study useful in trying to understand the variables that cause interest rates to rise. Donors and investors who would like to join microfinance sector or support poverty alleviation, would also benefit by making decisions that would lead to optimal benefit to the majority poor.

CHAPTER TWO

2.0 LITERATURE REVIEW

2.1 Introduction

This chapter reviews the importance of credit, world microfinance programmes, micro credit in Kenya and Africa characteristic of a good micro finance programme. The different micro finance lending models, micro finance theories, empirical evidence, regulation of microfinance institutions and how it impacts on lending.

2.2 Importance of credit

Micro finance can be defined as the provision of a broad range of financial services, such as deposits, loans, payment services, money transfers and insurance to the poor and low income households and their farm or non-farm micro enterprises (Charitonenko and Campion, 2003). Micro finance is the supply of loans and saving services to the poor. Most approaches to microfinance lie between the two extremes used as bench makers here. The poverty approach and the self sustainability approach (Schreiner, 1997). Most economic models assume that worth of clients is the increase in business profits with - versus without access to micro finance. In fact micro finance may improve the welfare of the poor even if it does not increase profits, so the increase in profits is just a lower bound on total worth; often the most important effect of microfinance is to help households to diversify their sources of income (Morduch et. al. 1998).

The worth of micro finance to clients is only part of the worth of micro finance to society, for example if microfinance strengthens small enterprises, then it may also help non clients through new hires or through backward and forward linkages (Schreiner, 1972). It is difficult to measure worth to clients, in part because worth depends on the subjective gain that a client gets from financial contract and in part because it is difficult to know what would have happened in the absence of micro finance, for example Hulme and Mosley (1996) found that the change in net income in a year for 16 experienced borrowers in Bancosol was about twice that of 16 borrowers who just got their first loan.

Micro finance is very closely related to the real economy, it is about lending money to the poor in order to help them get out of poverty. Mohammad Yunus (2010) while addressing participants during microfinance conference in Nairobi said that microfinance institution should take centre stage in the provision of financial services and urged leaders to make access to credit a human rights issue, he reminded the participant that it is time for new thinking, a new mindset and redefinition of financial system.

Micro credit have the best chance of succeeding in Africa particularly in helping women, unfortunately, the financing is never brought to them (Yunus, 2010). According to Mohammad Yunus (1999), economists have failed to understand the social power of credit in economic theory, credit is seen as merely a means with which to lubricate the wheels of trade, commerce and industry, in reality, credit creates economic power which quickly translates into social power. In both rich and poor countries alike credit institutions have favoured the rich and in so doing have pronounced a death sentence on the poor. Banks do financial segregation and get away with it as a result of this, the poor depend mainly on informal finance.

Stephen Funk (2010) a businessman from Canada and also the chairman of advisory board of the micro credit campaign initiative in Canada said that microfinance gives individual dignity and respect and which once they have they in turn respect others. It also gives them a feeling that you can achieve anything through hard work. Funk says that microfinance impacts health care, environment, education and peace indeed it creates prosperity. He says that microfinance is the only thing that has the best chance of eliminating poverty in the world.

Microfinance has become a world wide movement, the rise in this movement represents a remarkable accomplishment to say poor people can be bankable so long as they are provided with the products that meet their needs. The idea that poor people are not bankable is being overturned and in that process a variety of lending methodologies are being developed and has demonstrated that it is possible to provide cost effective services to the poor and to improve their living standards. It must be emphasized that microfinance was developed under the principle of alleviating poverty and not just about

providing access to capital (Baumann, 2001). That is improving the sources of income and assets for the poor so as to enable them to make their way out of poverty.

2.3 Concept of Competitive advantage

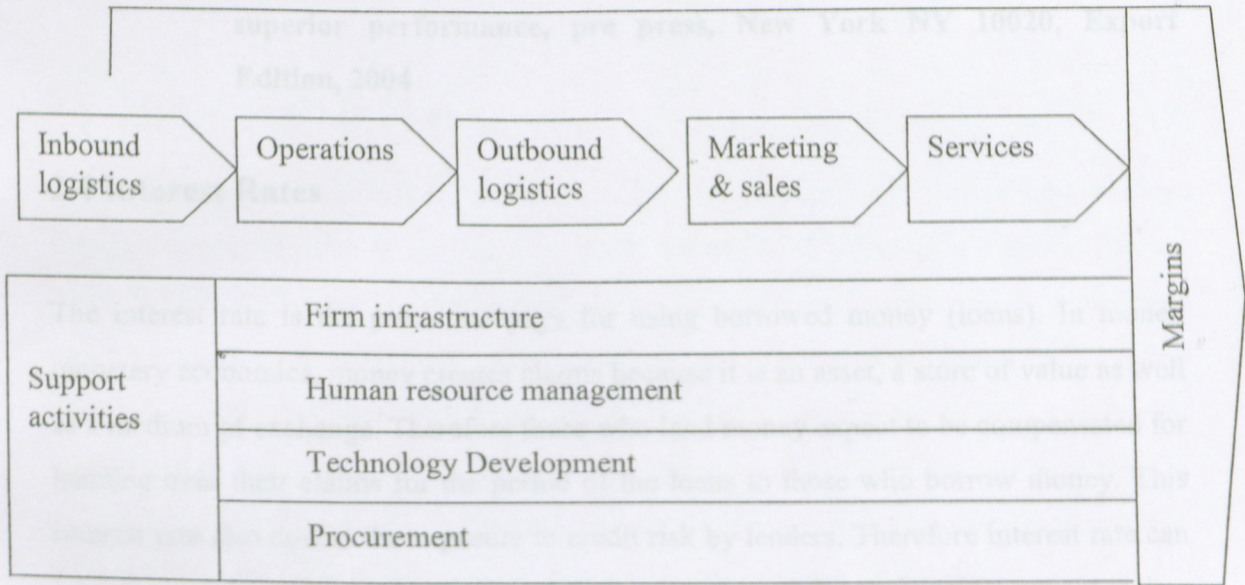
Competitiveness depends on how a firm can operate more profitable than industry average (Porter, 1985). The industry average competitiveness is determined by Porters five forces of sellers, buyers, rivalry new entrants and substitute products. The firm will be competitive if it controls one or more of this forces. The behaviour of a player may result to other players' actions that will affect sustainability of competitiveness. The goals of many organizations is to attain a sustainable competitive advantage, resulting to a superior value advantage. A firm will therefore choose to be focused, differentiate or be a cost leader (Porter, 1985).

Cost leadership seeks to achieve low price in the market than competitors (Johnson and Scholes, 2002) while maintaining value of product and services. This is through economies of scale (Porter, 1985) and should not be confused with capacity utilization. Differentiation seeks to provide uniqueness to the product and service to what if offered by competitors (Johnson and Scholes, 2002). Further Porter (1985) comments that cost leadership and differentiation leads to competitiveness advantage in a broad range of industry segment and focus select a certain market segment or wider market segment. Porter (1985) suggests that a firm may choose one of the four competitive scopes of cost leadership, differentiation, cost focused or differentiate focused. The search should be effective positioning in relation to competitors to achieve competitive advantage (Johnson and Scholes, 2002). Porter (1985) argues that accounting analysis of cost into direct and indirect cost is not the best way of analysing cost and he came up with a value based method, he called this a generic value chain model. The model analyses the activities into primary supporting activities, as depicted in figure 1.

Primary activities in the model represent the physical movement of value to buyers from suppliers whereby the firm is seen as a bridge. The activities include inbound logistics, operations, outbound logistics, marketing and sales services. Support activities are firm

infrastructure, human resource management, technology development and procurement and they support all the primary activities equally. A firm success lies on how it allocates resources to the value activities to generate economies or diseconomies of scale (Porter, 1985) to be a cost leader. The allocation of resources will provide value for money services and products (Johnson and Scholes, 2002). A firm will gain competitive advantage by performing strategically important activities better or cheaper than competitors. Motari (2002) noted that firm must restructure through application of business process re-engineering that will eliminate unnecessary procedure and improve necessary one.

Figure 1: Generic value chain model



Source: Porter M. E. (1985) Competitive advantage creating and sustaining superior performance, pre press, New York NY 10020, Export Edition, 2004 pp. 37

If a company does not improve its performance over time, sooner or later it will loose its competitive advantage and eventually drop out of the market (Porter, 1985). Thus, the Charles Darwin law of natural selection can be applied to business firms that only those organizations, which best adapt to their environment are most likely to service the competition.

Figure 2: Porters generic strategies

Competitive advantages					
Competitive scope	Broad target				
	Narrow target				
<table border="1"> <tr> <td>1. Cost leadership</td><td>2. Differentiation</td></tr> <tr> <td>3 a) Cost focus</td><td>3 b) Differentiation focus</td></tr> </table>		1. Cost leadership	2. Differentiation	3 a) Cost focus	3 b) Differentiation focus
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Source: Porter M. E. (1985) Competitive advantage creating and sustaining superior performance, pre press, New York NY 10020, Export Edition, 2004

2.5 Microfinance in Kenya

2.4 Interest Rates

The interest rate is the price one pays for using borrowed money (loans). In money monetary economics, 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).

The interest rates charged on micro credit is one of the most discussed issues in micro finance, capturing the attention of both, the media and the industry analysts, while, micro finances is scrutinized as a tool for providing credit in developing countries interests rates have once again captured public interests and alternative models for looking at interests rates and operating costs have received renewed attention. At the heart of discussion is how micro finance institutions (MFIs) can fulfill their social obligations while charging

their clients interest rates that are higher than those offered by non microfinance financial institutions such as traditional commercial banks (Mohammed Yunus, 2010).

Group 2016)

Interest charged on loans is the main source of income for MFIs, thus they must be high enough to cover operational costs (Fernado 2006). Since micro lending remains a high cost operation interest rates remain high, Fernando reports that MFIs in the Asia pacific region charges interests between 30 to 70% a year. Still there is much to be gained through lower micro credit interest rates, the current high costs means micro credit efforts are not reaching as many people as they could. Lower micro credit interest rates will increase the depth and breadth of availability of affordable finance for poor households (Fernado 2006).

Paula Yaro and Kenya Women Finance Trust (KWFT) microfinance institutions have already moved to depositary financial services. KWFT

2.5 Microfinance in Kenya

The Kenyan government has improved the regulatory climate for microfinance providers through various legislative reforms that allow the sector to thrive in a systematic way. This include enactment of the microfinance Act. 2006 to provide a more enabling environment for microfinance institutions and the savings and credit co-operative societies (SACCOS) Act 2008. The performance of a large number of co-operative microfinance institutions Treasury and the microfinance sector players are also in consultation on further appropriate reforms of the legal and regulatory framework to enhance the regulatory framework to enhance the effectiveness of the sector.

The K-Rep group started in 1984, as a five year project to address the financial, management and technical needs of non-governmental organizations involved in the micro and small enterprises development sector. From its humble beginning in the late 20th century K-Rep has changed, evolved and developed into a respected multi-functional micro-finance enterprise that is poised to meet the challenges of the African microfinance industry in the 21st century. The groups 'vision is to empower low income earners and serve as a catalyst for them to increase their participation in the development process and to enhance their quality of life. The K-Rep Group mission is to accomplish this through

development of finance interventions that aim at creating institutions and mechanisms, which serve to enable low-income people to better organize their financial lives (K-Rep Group 2006).

Equity Bank has its origins in central Kenya around 1970's where farmers joined hands in informal grouping to assist each other to buy plots and build, it grew to a building society and finally developed to a fully fledged bank in late nineties to early 2000. Equity bank to date has continued with its lending model where they target the lower segment of the market which comprises of the unbanked, by doing away with stringent borrowing terms which hinder access to credit. Out of the 8 million Kenyans with bank accounts equity bank has almost half of the total (CBK 2010).

Faulu Kenya and Kenya Women finance Trust (KWFT) microfinance institutions have evolved over the years and have already moved to depository financial services. KWFT was founded in 1981 as an affiliate of women's world Banking (WWB) by professional women in Kenya to provide financial services to women in the country. KWFT's mission is to advance and promote the direct participation of economically active women in viable business to improve their economic and social status by providing financial and non-financial services (McCormick, 1996).

KWFT made a leap in 1991 after a change in top management that has resulted in re-energized period of growth in terms of active members disbursement, outstanding loans, professional staff and penetration of all breadth and width of the Kenyan nation. The microfinance sector and practice embraced by Kenya, has managed to reach most unbanked Kenyans and has an estimated membership of 6.5 million people in the country.

M-Pesa is the product name of a mobile phone based money transfer service of Safaricom (mobile phone providing company in Kenya) which is a Vodafone U.K. affiliate. It was entirely developed by Kenyans and was initially sponsored by the UK based department of International Development (DFID) in 2003 -2007. The initial concept for M-Pesa was

to create a service which allowed microfinance borrowers to conveniently receive and repay loans using the network of Safaricom airtime and resellers (Hughes, 2007). M-Pesa has quickly captured a significant market share for cash transfers and grow astoundingly quickly capturing 6.5 million subscribers by May 2009. With 2 million daily transactions in Kenya alone the growth of the service forced formal banking institutions to take note of the new venture and as a result in December 2008, a group of banks reportedly lobbied the Kenyan finance minister to audit M- Pesa in an effort to at least slow the growth of the service. The play failed as the audit found that the service is robust (Philanthropy Action, 26 February, 2009). Microfinance experts say that with the advent of technology such as M-Pesa Safaricom money transfer services, micro finance institutions will greatly improve access to financial services because already a greater number of the unbanked own mobile phones (Finmark, 2006). Such individuals will be able to access financial services from micro finance institutions and the transaction costs will also greatly be reduced.

2.6 Characteristics of Good Micro Financing Programme

According to Garson (1998) there are approximately seven guidelines that provide good practices for microfinance management, first the development and implementation of microfinance program facilitate organizational and operational systems that are set up as part of the programme; second the success of microfinance program greatly depends on the degree of networking incorporated into the program, but within the community in which it operates and external agencies and institutions; third, they bring the community together and facilitate the development of kinship among the residents which facilitate the implementation and success of microfinance institutions activities. Fourthly, microfinance programs provides residents with appropriate skills and vocational resources in order to aid them in better utilizing their credit, fifth, leadership training programs nurture good community leaders who provide a representative voice for the community; sixth building trust among the community leaders, borrowers, non-governmental organizations and other stakeholders is an important aspect of microfinance programs. It is important in order to obtain good repayment and recovery

schedules. Finally good, microfinance programs provide small business management training and skills to enhance performance.

Mohammed Yunus (1991) notes that experts on poverty alleviation insists that poverty alleviation is absolutely vital for the poor to move up the economic ladder. He says that the poor have no control of capital and it is the ability to control capital that gives people the power to rise out of poverty, giving the poor access to capital allows them to immediately put into practice, the skills they already know-to weave, husk rice paddy, raise cows and peddle a rick saw and the cash they earn is then a tool, a key that unlocks a host of other abilities and allows them to explore their own potential.

2.7 Microfinance Models

2.7.1 Grameen model

The most commonly known model is Grameen model. The Grameen model emerged from the practices of the Grameen Bank, started by prof. Mohammed Yunus in Bangladesh. The model consists of a bank unit set up with a field manager and a number of bank workers covering an area of about 15 to 22 villages. The manager starts by visiting villagers to familiarize themselves with local culture, in which they will be operating and identify prospective clients as well as explain the purpose, functions and operations of the bank to the local population. Groups of five prospective borrowers are formed, in the first stage only two out of the first five group members are eligible for and receive a loan. The groups are observed for a month to see if members are conforming to the rules of the bank. The restrictions provide substantial group pressure to keep individual record clear. Therefore collective responsibility of the group serves as collateral on the loan (Hassan, 1997).

2.7.2 Cooperative model

This model has emerged from the practice of credit cooperatives or credit union, that operate in developing countries. The model is based on

- i. Owner managed firms, where all members have an equity interest in microfinance organization.

- ii. Distribution of benefits through lower-cost member services and higher returns on member deposits.
- iii. Savings mobilization

Membership is targeted at below poverty line household that cannot access financial services from the banking sector cooperatives or credit unions specialize in being a financial intermediary and may offer their membership personal development program. Many cooperatives had their beginning, as informal savings clubs or rotating savings and credit associations (ROSCAS) that were groups of individuals who come together made regular contributions to a common fund, which was then given as a lump sum to one member in each cycle (Remenyi, 1997).

2.7.3 Intermediary model

Remenyi (1997) observes that the intermediary model of credit lending positions a 'go between' organization between the lenders and borrowers. The intermediary plays the role of generating credit awareness and education among the borrowers. The activities are geared towards raising the credit worthiness of the borrowers in order to make them attractive to lenders. The links developed by the intermediaries could cover funding, program links, training and education and research. Intermediaries could be individual lenders, NGO's micro enterprise/microcredit programs and commercial banks lenders could be government agencies, commercial banks and international donors. This is the model currently used by Equity Bank through Equity foundation.

2.7.4 Village bank model

The village Bank model tends to serve poor, predominantly female clientele, similar to Grameen Bank. According to Murdoch (1999) the sponsoring agency makes an initial loan to the village bank and its 30-50 members. Loans are then made to members, starting at around ksh. 4000 with a four month term, with subsequent loan size tied to the amount that members have on deposit with the bank the initial loan from the sponsoring agency is kept in an external account and the interest income is used to cover costs, the aim is to build up internal accounts so that external funding could be withdrawn within three years. The Bank Kredit Desa (BKD) system in rural Indonesia is an example of a

successful village bank that has harnessed local information and peer dynamics. Most village banks require subsidies to cover costs because most have been set up in areas that are difficult to serve (murdoch 1999).

2.8 Theories of Micro Finance

Microfinance is widely accepted as one of the most effective ways of eradicating poverty. Interest rate charged therefore is of great concern to all because it can impede repayment and make loans inaccessible to the majority poor. The main theories are as outlined here below.

2.8.1 Financial sustainability theory

Also referred to as the financial systems approach or sustainability approach. It underlies the models of micro finance promoted since the mid 1990s by most donor agencies and the best practice approach promoted in publicans by USAID, UNDP and CGAP. The ultimate aim is to grow large programmers' which are profitable and fully self supporting in competition with the private sector and banking institutions and can borrow funds from international financial markets rather than relying on funds from development agencies. The main target group, despite claims to reach the poorest is the "bankable poor, small enterprises and farmers. This emphasis on financial sustainability is seen as necessary to create institutions which reach significant numbers of poor people. In the context of declining aids budget and opposition to welfare and redistribution in micro economic policy. Micro finance involves the delivery of all loans and other financial services which the poor can use to build up their assets, establish or further develop a business increase their wealth and protect against vision, pioneered by Mohammad Yunnus who founded the Grameen Bank in Bangladesh in the 1970s.

Micro finance institutions today are spread all over the world and count over 100 million of the world's poorest among its clients, this segment of the population has often had no access to traditional banks subsidized lending schemes. Meanwhile those that have tried to reach the poor have often proved inefficient to overcome the screening, monitoring

enforcement problems that restrict the access of the poor to the formal financial sector (Hulme and Moore, 2008). Micro finance on the other hand offers the promise to overcome these hurdles through innovations that include group lending that takes advantage of peer monitoring and joint liability, very small loan amounts, frequent repayment and the establishment of compulsory savings accounts by loan recipients.

Interest rates are normally very high both due to the high transactions costs involved in processing high volume, low value loan, and to protect the bank from risky borrowers, allowing the members to form their own group. With other safe borrowers and risky borrowers will be put with risky borrowers, hence the bank can charge lower interest rates to safe borrowers and high interest rates to risky ones. The interest rates also decline according to client or group reliability and punctuality in repayments for more than one year.

2.8.3 Poverty eradication theory

2.8.2 Women empowerment theory

The theory of poverty eradication underlies many NGO integrated poverty targeted. Another key feature of microfinance programmes is that they are mostly directed towards women on average 90% of the clients of micro finance institutions (MFIs) are women. Women make up a large section of informal businesses and microfinance often involves self employment in the informal sector (Armendaris and Murdoch, 2007). Moreover it has been noted that women being more credit constrained than men are more likely to engage in micro finance programs and participate regularly in training sessions and weekly meetings. They have also been viewed as more conservative in their investment strategy, more responsive to the peer pressure for repayment and therefore more responsible in repaying loans. Targeting loans to women also fosters their empowerment. Feminist activists writing often promoted empowerment of individuals and organization of women Sen and Grown (1997) but vary in the extent to which they conceptualize or discuss how to identify it. Organizations world wide set up credit and savings components both as a way of increasing women's incomes and bringing women together to address wider gender issues.

From the mid 1990s there was mushrooming of donors, government and NGOs sponsored credit programmes. In the wake of the 1995 Nairobi women conference

Myoux (1998) microfinance for the poor and women has received extensive recognition as a strategy for poverty reduction and for economic empowerment. Myoux (1998) explained that, the provision of micro finance appear to be one form of enterprise development assistance that can benefit the poor particularly rural women as well as having potential to pay for itself. He added that it must always be recognized that even if the institutions become self sustaining, in the long term, they come into being as a means of making a significant difference to the lives of specified target group, normally the urban or rural poor. Consequently the impact that they have in the lives of this people must continue to be evaluated at the same time as the institution's own performance and operations.

2.8.3 Poverty eradication theory

The theory of poverty eradication underlies many NGO integrated poverty targeted community development programmes. Poverty alleviation is defined as the ability of market incomes to encompass increasing capabilities and choices and decreasing the vulnerability of poor people, Bakhtiari (2006). Micro finance focuses on developing sustainable livelihoods, community development and social service provision, this includes literacy, health care and infrastructure development. Policy debates particularly on the importance of small savings and loan provisions for consumption as well as production group formation and the possible justification for some level of subsidy for programmes working with particular contexts. Some programmes have developed effective methodologies for poverty targeting and/or operating in remote areas such strategies have recently become a focus interest for some donors as well as the micro credit summit campaign. Mohammad Yunnus (1984) argued that availability of credit to low income households can thus greatly enhance break of the circle at a poverty.

2.9 Regulation of micro finance institutions

2.9.1 The microfinance Act 2006

Admittedly, the growing interest in the supervision and regulation of MFIs has been fuelled by a number of factors. Christen and Rosenberg (2000) identified at least three of these factors. They argue that first NGOs engaged in microfinance activities would like to attain regulatory recognition in order to access public deposits and donor credit lines and further that MFI practitioner's view regulatory recognition as a reputation enhancing mechanism. Second regulators and government agencies are concerned with the weak governance structures and business practices of some MFIs, which for example, charge surprisingly high interest rates (Christen and Rosenberg, 2000). The state and some donors as well view these rates as exploitative and hence the need to establish a regulatory regime under which loans can be prudently provided to the poor. The third argument is that regulations of MFIs could serve as a means for the state to clamp down on troublesome foreign NGO, or other groups it would like to control more tightly.

The government has made a positive, step in regulating microfinance institutions through the establishment of microfinance Act. 2006, this Act separates the regulation of community banks and the micro finance deposit taking banks based on their capital requirements. Microfinance Act 2006 makes provision for the licensing, regulation and supervision of microfinance businesses it provides regulation frame work for microfinance institutions and pro- poor programmes. The Act applies to every deposit taking microfinance business, providing loans or other facilities to micro or small enterprises and low income households. The Act addresses issues such as licensing, governance, supervision and protection of depositors. It sets out the minimum capital requirement and provides for a two tier regulation for the deposit taking microfinance organization. Governance issues relates to maintenance of minimum capital requirement, maintenance of minimum capital requirement, maintenance of minimum liquid assets, declaration of dividends, prohibited activities, insider lending, limits in shareholding and management of institution. Supervision aims at ensuring compliance by institution. The Act provides for inspection of institutions for breach contravention of the law, irregularities, mismanagement and periodic reporting.

2.10 Empirical studies

Micro credit is not only provided in poor countries but also in some of the world's richest countries. In USA 37 million people (12.6%) who live below the poverty line depend largely on micro credit. Other developed countries include Israel, Russia, Ukraine and more. The Israel Free Loan Association (IFLA) has lent out over \$ 100 million in the past two decades to Israeli citizens of all backgrounds, even so efforts to replicate Grameen style solidarity lending in developed countries have generally not succeeded. For example the Calmeador Foundation tested an analogous peer lending model in three locations in Canada. Rural Nova Scotia, urban Toronto and Vancouver during the 1990s, it concluded that a variety of factors, including difficulties in reaching the target market, the high risk profile of clients, their general distaste for the joint liability requirement and high overhead costs made solidarity lending unavailable without subsidies (Cheryl Frankiewicz, 2001).

The first micro-credit summit which was held in February 1997 in Washington D.C brought together more than 2900 delegates from 137 countries, they launched a nine year campaign to reach 100 million of the world's poorest families, especially the women of those families, this goal were almost met and in November of 2006 the campaign was relaunched to 2015, with two new goals, these include working to ensure that 125 million of the world's poorest families receive credit for self employment, and other financial and business services by the end of 2015. (Financial standard April 20th 2010) The Netherlands was the first country to create special financial institutions exclusively for small and medium enterprise sector in 1920s this was created with the participation of 25 small banks and the government as the major shareholder.

In China the Yilong microcredit program was set up as a Grameen style program. Program organizers put participants into a group of five called peer monitoring groups. Organizers intended for all participants to take loans on livestock projects and only in a minority of cases were participants allowed explicitly to take loans out for other activities (HongBinli, 2004). The recognition that poverty is not an exclusively southern phenomenon and that debates about social exclusion in the north and poverty in the south

may have much to learn from each other is an area of current and growing interest. Economic and social processes in the late twentieth century appear to be producing a south in the north (O'Brien et. al. 1997) one area in which parallel are already being drawn is that of microfinance.

Banco Solidario (Bancosol) of urban Bolivia also lends to groups but differs in many ways from Grameen. Bancosol focuses mainly on banking, not on social service. Also loans at Bancosol are made to all group members simultaneously. Their interest rate is higher at most double to that charged by Grameen Bank of Bangladesh, this also do not rely on Subsidies (Morduch 1999). Thus although Bancosol serves poor clients, the typical clients are among the richest of the poor and are clustered just above the poverty line (Murdoch 1999). Banco Rakyat Indonesia unit desa system is financially self sufficient and also lends to better off poor and non poor household, unlike Bancosol and Grameen, however Bank Rakyat Indonesia does not use group lending, they require individuals borrowers to use group lending, they require borrowers to put up collateral. The bank focuses on cost reductions, which they are trying to achieve through setting up networks of branches and posts to serve borrowers and depositors. The interests rate of their loans in real term ranges between 15 percent to 25 percent (Hassan et.al 1997)

Acosta Rican NGO called Foundation Intergral Campesina (FINCA) initiated revolving loan programmes of Grameen type in isolated rural communities. The FINCA Program has a two stage design, it organizes and trains joint liability groups who receive a series of graduated loans ranging from approximately \$50 to \$400 per person in the first stage and up tot \$2000 in the second stage. Loan terms are usually one year in the first stage and up to to five years in the second stage. Interest rates are subsidized. Strong credit groups have used accumulated savings to finance playground construction to restore cemeteries and to improve roads (Paxton, 1998).

Banco caja social in Columbia is a unique institution within the microfinance community, even though it serves over 1 million clients; it does not have international exposure like other large micro finance institutions such as Grameen or Bank Rakyat Indonesia. The

reason for this is because Banco Caja social does not rely on international donor funds but instead has quietly mobilized local deposits for nearly 90 years (Paxton, 1999). In Australia, after world war II, the Burgess forerunners bank was established to assist start ups by providing small and medium enterprises with special loan guarantee, which help to overcome high risk faced by financial institutions when lending to micro and small scale businesses, this enabled the provision of more financing to the sector, by both the banking and public sectors, than would be the case without the scheme (Szabo 1997). Srinivas and Muhammed Yunus formed the Grameen bank in 1976 in Bangladesh which is the outstanding model for many micro lending institutions; it was formed in realization of the need to provide small loans to both small scale start-ups and support in their growth. The bank designed several methods to make sure that those who desire the loans get them whether they have collateral or not.

The Zambuko trust began in 1992 when a group of influential Zimbabwean business community and church leaders formed a board of trustees with the goal of establishing an organization that could serve as a link between the under privileged and opportunities for enterprise and income generation (Malhotra & Ridler 1995). Zambuko is now officially registered as two distinct legal entities, one being a social welfare organization while the other is a lending entity allowed to charge interest on its loans. Zambuko receives high marks for servicing some of the hardest to reach and poorest elements of the Zimbabwean population and enjoy the deepest outreach of any small scale finance institution in Zimbabwe. Zambuko clearly defines its customer as the economically poor, and the targeting criteria and lending methodology ensures outreach into these areas (Malhotra & Ridler 1995).

Burkina Faso le project du petit credit rural (PPPCN) has been particularly innovative in adapting the Grameen style of group lending to the condition in West Africa. The combination of failed previous efforts, low population density, poverty and illiteracy makes the sahelian region one the most challenging environments for micro-finance. In preparation for these obstacles, the PPCN has separated from a pure Grameen replication and has adapted to its own financial services and organization. (Hassan et.al 1997).

In spite of all the careful and meticulous modification of the Grameem model to the Burkina faso context, the provision of micro-financial services has proven to be quite costly in the sahelian region. The high costs can be more closely linked to low population density, poor infrastructure, poverty and illiteracy than to the style of group lending itself. The people have experienced greater efficiency in the past couple of year as it continues to learn from its early experience and achieve economies of scale. The extent to which this improvement can contribute will determine whether or not this approach will become viable and sustainable in the future (Paxton 1996)

Research on determinants of profitability of micro finance institutions in Kenya was done by Kamau (2008). She found out that developments in the micro finance industry have involved the transformation of MFIs into banks or other forms of regulated institutions. MFIs are moving more and more towards profitable areas seeking the best returns related to the amount or level of risk their stakeholders are willing to bear, therefore sufficient profits must be generated. Research on the nature and basis of competition within microfinance industry in Kenya carried out by Kenneth, [2007] investigated the competition within the MFI industry on the basis of porters five forces models. He concluded that indeed competition as experienced by the players was reported to exist in all the fronts modeled by porter. MFIs however have not succumbed to the competition but instead have grown tremendously, therefore raising the question for research what strategies have MFIs used to enable survival and growth in recent past. Atieno (1998) observed in a survey done in Kenya that about 70% of the respondents got their initial capital from family friends and relatives, while 81% got their operating capital from same source in both Ghana and Nigeria. Aredo (1993) notes that saving with formal institutions in Ethiopia is not popular mainly because of the low capacity to save. Aryeetey and Gockel (1991) points out similar cases in Ghana.

Obuya (1995) observes that loans advanced through K-Rep Juhudi programme bear a service charge that is a percentage computed on weekly declining balance payable in weekly installments on each loan repayment. In addition to the service charge each applicant pays a fee of KSh 100 along with the loan application. The loans are paid

weekly for a period not exceeding 52 weeks from the date of disbursement. Many claims made about the efficiency and usefulness of micro lending programs are challengeable, as revealed by the experience of United Nations (UN) agencies working with the NGO community. In particular actual loan repayment rates are not as high as claimed, while real cost to micro entrepreneurs are usually much higher than reported and publicized. Many people especially the poorest don't have business skills and even the motivation for business (Grameen Dialogue, 1998b).

Wahid (1994) found out that the loan recovery rates with "graduated borrowers" (those who are engaged in taking second or more loans) is relatively lower than the new borrowers. To explain this Wahid makes the point that in many cases the "graduated borrowers" would have successfully lifted themselves above the poverty line but there is lack of innovative funding appealing economic activity hence a sense of disillusionment and subsequent under performance. Khandker (1998) observes that although micro finance programmes have improved loan repayment rates and seem to be better than other programs aimed at the poor. They have high transaction costs increasing dependence on subsidized resources for lending and do not break even at the market cost of these resources. Although many microfinance programs reach the poor and do recover loans, many are unable to fully lower their operational costs. To become fully financially self sustainable, they would need to charge rates of interest that would be too high for poor borrowers to bear.

On the issue of inflated repayment rates Elahi and Danopoulos (2004) observe that the performance of micro lenders is much better than those of commercial and other specialized banks, no matter what the repayment rates are. In many developing countries, a few borrowers, who are also the largest defaulters, hold the bulk of commercial loans, thus the criticism about micro credit is one sided. Ebdon (1995) found in the case of Grameen Bank that most women would simply be given money by their households to cover the weekly repayments and hence their economic status was not improved. Karim and Osada (1998) found that those members who dropped out of Grameen Bank groups within their seventh year of membership, 88% did not move out of poverty. Oriaro (2001)

established that the dominant characteristics of MFIs that hinder regulating are targeting low-income asset-less clients. Extending unsecured loans based on group guarantee and capitalization by donors.

There are widespread accumulation of studies that indicate that the Grameen Bank system does not reach very far down the poverty (spectrum) either in absolute terms or relative to other income categories (Islam Tazul, 2007) he says that there is risk to exclude those below the poverty line, since the client of the banks incline to be clustered around the poverty line of predominantly moderately poor or vulnerable non-poor. Also of the poor who join the banks micro credit programs, a high percentage often drop out after only a few loan cycles, while many others eventually drop out in later loan cycles as loan amounts begin to exceed their repayment capacity.

2.11 Chapter Summary

The recent development of micro-finance has made it possible to expand financial services to reach a larger segment of the poverty stricken population. Public interest in promoting the growth of micro-finance is due to the realized difficulty in providing financial services to this target population and its potentially welfare enhancing characteristics. The challenges include, the transaction services being expensive, the risk involved in lending to poor clients and the cost involved in lowering these risks is high and risk of losses from default is high.

From the literature it can be concluded that the key objective of MFIS is to provide microcredit and other financial services like savings to the otherwise excluded poor people and help them out of grinding poverty. A bigger chunk of micro finance institutions and banks profit is derived largely from interest rates. Interest rates can be a major impediment to access and even repayment of loans. Of late banks interest rates have been on the downward trend and competition is becoming stiffer by the day, banks are coming up with innovative products targeting the masses (mostly the unbanked) with very friendly credit terms. However most of the poor people do not trust the banks and continue to lend from informal sources and micro finance institutions.

CHAPTER THREE

Most of the reviewed literature concurs that small loans are expensive due to high transaction costs, monitoring costs and limited information (information asymmetry). This study seeks to contribute to existing literature by establishing the effective rate of interest charged by micro finance institutions and comparing it with the rates of interest charged by mainstream commercial banks in Kenya.

3.2 Research Design

The research used a survey design. Mugenda and Mugenda (1999) stated that the descriptive survey is a method that is used to collect data from the population and help the researcher to get the descriptive of existing phenomena. Survey method is useful when a researcher wants to collect data on a phenomenon which cannot be observed directly. It is advantageous to use because it allows the collection of large amounts of data from the population effectively and economically.

3.3 Population of Study

According to Kombo and Tromp (2016) a population is a group of individuals, objects or items from which samples are taken for measurement. The population used in this research composed of all twelve microfinance institutions operating in Migori County, licensed and regulated under the Micro Finance Act 2006. The research targeted bank managers or credit officers.

3.4 Data Collection

The study used both secondary and primary data. The primary data was collected using structured questionnaires that was administered to the Branch managers or credit officers of micro finance institutions. The questionnaires used structured closed ended questions which helped to get specific answers to the data to answer and could be easily analyzed. All respondents were given a copy of the questionnaire and the data was collected.

CHAPTER THREE

3.0 RESEARCH METHODOLOGY

3.1 Introduction

This chapter discusses in detail a description of how data would be obtained, processed, analyzed and interpreted to fulfill the research objectives. It highlights description of the research design, the research variables and provides a broad view of the selection of the population.

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3.4 Data Collection

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used . Secondary data was obtained by analyzing published journals of banks, reports and opinions of regulatory bodies like central bank of Kenya. (CBK)

3.5 Data Analysis Technique

Data analysis involves organizing, accounting for and explaining the data, that is making sense of the data in terms of respondent’s definition of the situation, noting patterns, themes, categories and regularities (Gay, 1992).The data collected was thoroughly examined and checked for completeness and comprehensibility. The data was then summarized, coded and tabulated. According to Sambili (2000) this assisted to clean up the data and to avoid contradictions and therefore ensure internal consistency.

Descriptive statistics such as means, weighted averages, standard deviations and frequency distribution was used to analyses the data. Data presentation is done by use of, percentages and frequency tables. This is to ensure that the analysis is easily understood a t a glance. The variables of this study include effective interest rate as a dependent variable on independent variables such as, transportation cost, to and from the premises of the micro finance institutions, insurance charges on loans advanced, deposits without interest as a cost of loan to the borrower, bank charges during withdrawing of cash plus the nominal interest charged. Competitiveness of micro finance institutions is to be determined through a comparison of the rates of interest charged by MFIs.

	Number	Percentage
Accepted	2	16.67%
Not accepted	2	16.67%
Accepted/Not accepted	3	67.67%
Total	17	100

CHAPTER FOUR

4.0 DATA ANALYSIS AND INTERPRETATION

This chapter presents data on competitiveness of interest rates charged by micro finance institutions in Migori County. The objectives of the study were to ascertain the interest rates charged on loans advanced by micro credit institutions and to identify the impact of interest rate differences on borrowing by small scale traders. Data was collected from the field and was presented, analyzed and interpreted under data collection and response rate. Section A: Background (general information) of the business and respondent. Section B: Loan information and Section C: Credit assessment tools.

4.1 Data collection and response rate

Out of the 10 MFIs selected only 8 were analyzed, the two rejected did not fill in the most important sections of the questionnaire. This represented a response rate of 67.67%, which was considered adequate as a basis for deriving conclusions on the study. The reasons for non-response included suspicion for theft of business ideas by competitors, lack of time and delay in getting authorization form headquarters. 12 questionnaires were administered to 12 MFIs in Migori County during the month of September and October. The finding and conclusions were based on the 67.67% response rate.

Table 1: Response Rate of Respondents

	Number	Percentage
Rejected	2	16.67%
Forms not returned	2	16.67%
Received/accepted	8	67.67%
Total	12	100

4.2 Background of micro finance institutions

The background information included the number of years since establishment in Migori County, position of the respondent, ownership of the micro finance institutions, number

of branches they have in Migor8i county and Kenya. Out of the 8 respondents, five were branch managers, 2 credit officers and 1 loan clerk.

Table 2: Profile of respondents and firms

Years served in the firm

Period	Frequency	Percentage
Below 1 year	2	25%
Above 1 year – 5 years	4	50%
Above 5 years	2	25%

The analyses from the responses received from the 8 MFIs as shown above indicated 25% of the respondents had served in the organizations for a period below 1 year while 50% had served upto 5 years. Only 25% had served for more that 5 years with their respective firms. No respondent had served for more that 10 years. The analysis also indicate that 62.5% of the respondents were managers while 25% were credit officers with only 12.5% as loan clerks.

Table 3: Length of firm’s existence in Migori county.

Length	Frequency	Percentage
0 - 3 years	4	50%
3 – 5 years	1	12.5%
Above 5 years	3	32.5%

From table 3 it was found that 50% of the firms were in existence in Migori county for less than 3 years while 37.5% were in existence for more than 5 years with only 12.5% being in existence for between 3 to 5 years.

It was also found that all microfinance institutions are privately owned mostly by NGOs.

4.3 Loan information

Table 4: Most important reasons for loan rejection

Reason for rejection	Frequency	Percentage
Insufficient credit history	0	0%
Poor repayment in previous loan	4	50%
Lack of sufficient collateral	0	0%
Project not profitable	3	37.5%
Other reasons	1	12.5%

From the table 4 it is clear that most MFIs look at the previous credit repayment (50%) followed by appraisal of the projects to be invested in at 37.5% while insufficient credit history and collateral did not count for much.

Table 5: Amount of loan mostly requested for

Amount of loan requested	Frequency	Percentage
1000 – 10,000	0	%
10,001 – 50,000	7	87.5%
50,001 – 100,000	1	12.5%
100,001 – 500,000	0	0%



From table 5 the analysis from the responses shows that majority of the borrowers take loans between 10,000 to 50,000, which might be as a result of small type of businesses which rarely expand or fear of large loans by borrowers or the MFIs, lack capacity to lend big loans.

Table 6: Repayment schedules as the amounts indicated

	MFI	Amount	No. of months	Amount per month	Total principal + Interest
1.	Financial services (K-REP)	10,000	9	1,261	11349
		50,000	11	5,305	63660
		100,000	12	9,833	117996
2.	Faulu – Kenya	10,000	9	12,510	11250
		50,000	12	4,160	59520
3.	KADET	10,000	6	1,970	11820
		50,000	12	4,996	59952
4.	ADOK TIMO	10,000	6	1,880	11250
		50,000	12	-	-
5.	KWFT	10,000	12	992	11904
		20,000	12	1,983	23796
		50,000	12	4,990	59880
6.	SMEP	20,000	6	3,667	22,000
		100,000	12	10,000	120,000
7.	Move on	10,000	6	1,980	11,880
		50,000	12	5,040	60,480
8.	Kenya Credit Traders Limited	10,000	6	2,170	13,020
		20,000	12	2,353	28,230
		100,000	12	12,920	155,040

Source: Research Data

From table 6 it is shown that most of the MFIs lent out less than 100,000, majority of them rarely provided a loan in excess of 100,000 save for KWFT. Repayment periods mostly were not more than 12 months, most of the MFIs also insisted on borrowers giving 1% of the loan as savings on top of the monthly repayments.

Effective interest rate charged calculated using compound interest formula for at least five MFIs are as shown below.

Table 7: Interest rate charged

	Institution	Amount loaned	Model $A=P(1+r/100)^n$	Pa%	Pm
1.	Financial services (K-REP)	10,000	$11349=10,000(1+r/100)^9/12$	18.40%	1.41%
		100,000	$117996=100,000(1+r/100)^{12}/12$	18.0%	1.40%
2.	Faulu – Kenya	10,000	$11250=10,000(1+r/100)^9/12$	17.0%	1.32%
		50,000	$59520=50,000(1+r/100)^{12}/12$	19.04%	1.46%
3.	Kadet	10,000	$11820=10,000(1+r/100)^6/12$	39.71%	2.83%
		50,000	$59952=50,000(1+r/100)^{12}/12$	20%	1.52%
4.	Adok timo	10,000	$11250=10,000(1+r/100)^6/12$	27.28%	1.98%
		50,000	-		
5.	KWFT	10,000	$11904=10,000(1+r/100)^{12}/12$	19%	1.46%
		20,000	$23796=20,000(1+r/100)^{12}/12$	19%	1.46%
		50,000	$59880=50,000(1+r/100)^{12}/12$	19.16%	1.51%
6.	SMEP	20,000	$22110=20,000(1+r/100)^6/12$	20%	
		100,000	$120000=100,000(1+r/100)^{12}/12$	20%	
7.	Move on	10,000	$11880=10,000(1+r/100)^6/12$	19%	
		50,000	$60480=50,000(1+r/100)^{12}/12$	20.96%	
8.	Kenya Credit Traders Ltd	10,000	$13020=10,000(1+r/100)^6/12$	14.7%	
		20,000	$28230=20,000(1+r/100)^{12}/12$	41%	
		100,000	$155040=100,000(1+r/100)^{12}/12$	55%	

Note: Average interest charged

10,000 = 21.88%

50,000 = 24.68%

From table 7 above it is shown that some microfinance institutions charge exorbitantly high interest rates, that at time doubles the average interest charged. Like for example Kadet charges a loan of 10,000 as interest of almost 40% per annum while Kenya Credit Traders charges almost 55% interest per annum for a loan of 100,000 shillings. The variability of interest rates charged as large among the microfinance institutions is shown from the table like Kadet has average of 15% from the mean.

Table 8: Bank loans and repayment

Bank	Loan amount	Repayment	Period	Calculated interest rate
Cooperative Bank	50000	4678	12 months	17%
	50000	7485	12 months	17%
	100000	9356	12 months	17%
	150000	14034	12 months	17%
Barclays bank	80000	7652	12 months	18%
	100000	9565	12 months	18%
	150000	14348	12 months	18%
Equity bank	50000	4561	12 months	16%
	100000	9122	12 months	16%
KCB	10000	983	12 months	18.5%
	50000	1917	12 months	18.5%
	100000	9833	12 months	18.5%
Average interest				17.375%

Source: Research Data

From table 8 above it is shown that commercial bank interests rates has a very lower variability as compared to the microfinance institutions. Their interest rates average 17.4% with the highest charging 18.5% and the lowest which was Equity bank charging 16% for micro credit loans which do not exceed 200,000. However, banks despite their lower interest rates demand collateral which majority of the poor do not have thereby

forcing small type business men and women to seek for credit from microfinance institutions.

Table 9: Percentage notional interest rate charged per annum

Interest (%)	Frequency
15 – 16	0
17	2
18	5
Above 18	1

4.4 characteristics

Table 10: Character of borrower

	Frequency	Percent	Valid percent	Cumulative percent
Less important				
1	0	0	0	0
2	0	0	0	0
3	0	0	0	0
Most important	3	37.5	37.5	37.5
4				
5	5	62.5	62.5	100

Source: field survey

Table 11: Capacity to pay

	Frequency	Percent	Valid percent	Cumulative percent
Less important				
1	0	0	0	0
2	0	0	0	0
3	0	0	0	0
Most important	0	0	0	0
4				
5	8	100	100	100

The respondents from the above table 11 seems to agree that capacity to pay is very important in advancing loans to borrowing that is why they have all stated that it is the most important

Table 12: Economic conditions

	Frequency	Percent	Valid percent	Cumulative percent
Less important				
1	2	25	25	25
2	4	50	50	75
3	2	25	25	100
Most important 4	0	0	0	0
5	0	0	0	0

Table 12 shows that 25% feel that economic conditions prevailing is less important while 50% that it is important but not so much. It appears like the respondents were unanimous that prevailing economic conditions is not seriously considered while advancing loan.

Table 13: Collateral/security requirement

	Frequency	Percent	Valid percent	Cumulative percent
Less important				
1	6	75	75	75
2	1	12.5	12.5	87.5
3	1	12.5	12.5	100
Most important 4	0	0	0	0
5	0	0	0	0

From table 13 shows 75% of the respondents felt that collateral is, of little importance while considering advancing loans to clients, majority of MFIs secure their loans through the groups other than tangible assets owned by individuals.

Table 14: Capital growth/condition of the borrower

	Frequency	Percent	Valid percent	Cumulative percent
Less important				
1	7	87.5	87.5	87.5
2	1	12.5	12.5	100
3	0	0	0	0
Most important 4	0	0	0	0
5	0	0	0	0

Table 14 shows that 87.% of the respondents consider capital growth to be less important as a consideration for advancing loans.

CHAPTER FIVE

CONCLUSION

5.0 SUMMARY, DISCUSSION AND CONCLUSION

The study sought to ascertain the interest rates charged on loans advanced by micro credit institutions in Migori county and to identify the impact of interest rate difference on borrowing by small scale traders.

The study established that majority of microfinance institutions in Migori county were established less than 10 years ago; a sizeable number of MFIs which were established earlier had either collapsed or redesigned their risk management practices. Most of the microfinance institutions lent out between 50,000 – 100,000 to their clients.

Microfinance institutions had a very high turnover staff going by the number of years served, majority of the senior management had served for less than five years. It was also apparent that most MFIs rejected application for loans, due to poor repayment in previous loans and for projects whose business plans show that they are unprofitable. It seems that MFIs are not interested in collateral due to the guarantees offered by the groups in which the lender is, which ranges between 10 members upto 30 members because in case of default, the members would be forced to pay, they put a lot of pressure on whoever wants to fail to pay. A sizeable number of MFIs lend between 10,000 to 50,000 rarely would you find an MFI lending in excess of 100,000. This shows that most MFIs have clients who own small businesses and these businesses would not expand beyond certain limit or if they do they would look elsewhere for bigger credit elsewhere. Microfinance institutions lend for very short periods of time, indeed a majority insist on less than six months period and their maximum repayment period is 12 months, MFIs have numerous

charges on top of compulsory monthly savings from the members, due to small amount of loans advanced, the charges makes the loans expensive in real term for the borrowers. Interest rates charged by MFIs ranges between 17% for the lowest to 39% for the highest, compared to commercial banks, MFIS charges very high interest rates. Arguing that they serve risky segments of the lending market does not add up since most of their loans are secured through the groups and the repayment rates are normally very high, the only advantage of MFIs loans is that they do not need collateral like logbooks, for vehicle, land title deeds which are hard to come by in most poor neighbourhoods. Interest rates that microfinance institutions charge seem to be playing a bigger role in the number of clients that they attract for example in Migori county KWFT charges the lowest interest and has a total of 8 branches network, so accessibility and cost of loan seem to be a very important factor in determining competitiveness of MFIS because the repayment rate is low and the transport charges to the branches is near zero. MFIs customers also appear to value availability of MFIs offices where they transact daily business, more MFIs in Migori county do not have offices that function daily, the mobile units that operate from Kisumu or Kisii once a week is the order of the day and form the number of customers. It seems that their absence daily has caused them to loose against MFIs which have heavy presence.

Most of the MFIs are concerned about the character of the borrower and the capacity to pay compares to economic conditions prevailing collateral and growth of capital.

5.1 Limitation of the study

It was difficult to get MFI branch managers or credit officers to fill in the questionnaires at time it took over one month of prodding to get the questionnaire filled in and even then most questionnaires were not fully filled in the secrecy surrounding the interest rates charged in real terms was glaringly disturbing. Most MFIs employees felt that responding to the questionnaires was a waste of time and was not a priority.

There was time and money constrain because of the expansiveness of Migori county with poor roads making accessibility to most shopping centres a nightmare. Many microfinance institutions managers had a feeling that to give more information is like giving out so much secrets to the public.

5.2 Suggestions for further research

A study should be conducted to find out the effect of interest rates on business success and how group guarantees ensure that loanees repay their loans within the stipulated time frame regardless of interest charged, the businesses to be used in this studies should be those that started as small businesses operating on less than a capital of Kshs 50,000 and have expanded to at least a capital of Ksh 200,000 with proportionate increase on profitability.

A study should also be carried out to determine effect of interest rates on continued survival of MFIs, whereby data should be collected on customers of MFIs, that collapsed within the last five years and the interest rates that they charged and compared to microfinance institutions that are strict on operation and were also in existence five years ago.

5.3 Recommendations for policy and practice

The study recommends that for MFIs to continue with their most important mandate of poverty alleviation, they need to thoroughly review the interest rates that they charge and other numerous charges which clients are charged in order to access their loan facilities. MFIs branches should also be located near their clients to save on transportation and time wastage, when possible MFIs should have mobile branches where they can meet their clients more so on known market days. Since poverty alleviation is a responsibility of the government, the government should enter into partnership with MFIs to make loans affordable and accessible to the majority poor who have no access to capital to start to expand their businesses. There should be intensive training to respective loanees to enable them make informed judgment on where to seek a loan and the best methods of ensuring that they are not overcharged.

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APPENDIX 1:
LETTER OF INTRODUCTON

Dear Respondent,

This questionnaire is designed to gather information on competitiveness of Interest Rates Charged by Microfinance Institutions in Migori County in Kenya. The study is being carried out for a project proposal paper in partial fulfillment of requirements for the degree of Master of Business Administration School of Business, University of Nairobi.

The information in the questionnaire will be treated with confidentiality and in no instance will your name be mentioned in this research. The information provided will not be used for any other purpose other than for this research.

Your assistance in facilitating the same will be highly appreciated.

Thank you in advance.

Yours sincerely,

.....
MBA Student
Peter Ochieng' Nyawach

.....
Supervisor
Dr. Joshua Wanjare

APPENDIX 2:

LIST OF MFIs IN MIGORI COUNTY

1. FAULU KENYA
2. KADET LIMITED
3. ADOK TIMO
4. UNITED METHODIST WOMEN
5. KWFT
6. COMMUNITY FINANCIAL SERVICES (K-REP)
7. KENYA CREDIT TRADERS
8. PIONEER
9. DACE (DEVELOPMENT AND COMMUNITY EMPOWERMENT)
10. TANGAZA
11. MOVE ON
12. SMEP

Source: Ministry of Trade (Department of Social Services) and Municipal Councils of

Kuria and Migori

APPENDIX 3:

QUESTIONNAIRE

Instructions

BACKGROUND INFORMATION

1. Name of the micro finance institution.....
2. The year of establishment in Migori County.....
3. Position of the respondent.....
4. Length of time with the organization.....
5. Ownership
 - a) Government ☐
 - b) Private ☐
 - c) Foreign owned ☐
 - d) Any other indicate.....
4. How many branches does your organization have in Kenya?
.....
5. How long from the time application for loan is made do you take to make money available to the applicant
 - i) One day ☐
 - ii) One day to one week ☐
 - iii) Above one week ☐

LOAN INFORMATION

1. How many loan applications on average do you receive in a month?.....
2. What is the rate of approval in percentage.....
3. Among the loan applications that were rejected, what was the main reason for rejecting the loan application?
 - a) Insufficient credit history ☐
 - b) Poor repayment in previous loan ☐
 - c) Lack of sufficient collateral ☐

- d) Project not profitable investment []
- e) Age of business []
- f) Others specify.....
4. On average what is the amount of loan requested.
- Kshs 1,000 – 10,000 []
- Kshs 10,001 to 50,000 []
- Kshs 50,000 – 100,000 []
- Kshs 100,000 – 500,000 []
5. What is the repayment schedule as per the amounts indicated above
- | | Schedule | Monthly repayment |
|-------------------|----------|-------------------|
| a) Loan of 10,000 | [] | [] |
| b) Loan of 50,000 | [] | [] |
| c) Loan 100,000 | [] | [] |
| d) Loan 500,000 | [] | [] |
| e) Above 500,000 | [] | [] |
6. What is your percentage interest charged on loans (flat rate).....
7. What other costs apart from loan interest are your customers charged and how much
- a) Insurance
- b) Loan negotiation fee
- c) Loan processing fee
- d) Any other, specify.....
8. Do the charges in (7) above vary according to the loan amount and if they do, by how much for a loan between 10,000 – 500,000 on
- a) Insurance
- b) Loan negotiation fee
- c) Loan processing fee
- d) Any other, specify.....
9. What is the rate of default on loans advanced (in percentage).....

Credit Assessment

1. Who authorizes approval of loans
- a) Headquarters
 - b) Branch manager
 - c) Credit committee
 - d) Any other
2. Which of the following characteristics do you consider in the evaluation of an applicant before availing credit

Please list in order of importance

	Less important			Most important	
	1	2	3	4	5
a) Character of the borrower	[]	[]	[]	[]	[]
b) Capacity to pay	[]	[]	[]	[]	[]
c) Economic conditions	[]	[]	[]	[]	[]
d) Collateral/security available	[]	[]	[]	[]	[]
e) Capital growth condition of borrower	[]	[]	[]	[]	[]