

Abstract:

Many studies have approached the issue of transactions costs of microfinance from the institutional perspective with a view to drive recommendations on viable microfinance lending institutions. Only few studies have approached the same issue from the poor borrowers' perspective. The major objective of the paper is to fill in this gap by attempting a rigorous analysis of the determinants of transaction costs and their impact on borrowers' small business returns or income generation. The main hypothesis of the paper is that transactions costs especially those arising from joint liability affect small businesses' profitability substantially and therefore play an important role in poverty reduction initiatives. Empirical data used for the study was generated from a random sample of about 200 rural households in Makueni District Kenya. By use of statistical and qualitative methods the paper illustrates how group lending programmes involve individual borrowers in both joint and individual costs that result in lost incomes / business profits. It also examines how social capital, human capital, type of business, socio-economic attributes among other important factors affect the transaction costs and operations for individual borrowers in joint liability borrowing arrangements. Preliminary results indicate that the group borrowing approach weakens the social capital within the community while at the same time it increases the transactions costs of the whole group in case of loan default by a member (s). The paper concludes by discussing the role of transaction costs in establishing efficient and viable small business ventures among the rural poor with support from microfinance. It is emphasized that in order for microfinance to serve as a poverty reduction tool, it is important to minimize the transactions costs on the borrowers' side.