ROLE OF MICROFINANCE INSTITUTIONS IN FINANCIAL DEEPENING IN KENYA

BY

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DECLARATION

I hereby declare that this research project is my original work and has not been presented to any other university.

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This Research project has been submitted for presentation with my approval as University Supervisor.

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DEDICATION

The research project is dedicated to my ever loving Mother, Zelda Chepomet .What would I be if not for the sacrifices you made to get me through School, for your love, for your prayers and constant encouragement. Thank you for constantly reminding me to trust in God always.

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ABSTRACT

Micro finance continues to play a significant role in the lives of the poor in Kenya by responding to their needs, concerns and voices by providing easy access of financial services. Microfinance is seen as a solution to include on a large-scale previously excluded poorer groups without access to capital into the financial system. The objective of the study was to determine how growth of MFIs has contributed to financial deepening in Kenya. To achieve the objective, descriptive survey was used. The target population comprised 59 MFIs who are members of the AMFI-K. The study adopted a census study approach and used exclusively secondary data. Data was analysed using descriptive statistics. Statistical Package for Social Sciences (SPSS version 21) was used to analyze the data and the findings presented using frequency tables and charts. Multiple linear regression was used to establish the relationship between financial deepening and the predictor variable.

The study findings established that MFIs promote financial deepening in Kenya specially because they have contributed to steady increase in the number of depositors; this shows that more people have access to financial services. The study findings further established that gross loan portfolio, number of active borrowers and the returns on assets directly affects financial deepening .This therefore means that both financial growth and increase in outreach affects financial deepening(access) positively.

Due to the important role played by MFIs in financial inclusion in Kenya, the study recommends that policymakers should come up with policies that promote the operations of MFIs like regular and mandatory reporting of performance and laws that govern DTMs as well as credit only MFIs. The policies should also be geared towards making financial services more accessible to all Kenyans both women and men .

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ABBREVIATIONS AND ACRONYMS

AMFI-K:	Association of Micro Finance Institution, Kenya
ASCAs:	Accumulating Savings and Credit Associations
CBK:	Central Bank of Kenya
CGAP	Consultative Group to Assist the Poor
CBOs:	Community Based Organizations
DTM	Deposit Taking Microfinance
FBOs:	Faith Based Organizations
FD:	Financial Deepening
FHI:	Food for the Hungry International (FHI).
FSD:	Financial Sector Development
FSDK:	Financial Sector Deepening programme-Kenya
IDAS	International Development Assistance Services
K-Rep:	Kenya Rural Enterprise Programme
KYC:	Know-Your-Customer
MFIs:	Microfinance institutions
M4P	Markets for the poor
MSMEs:	Micro, Small And Medium Enterprises
NGOs:	Non-Governmental Organizations
ROSCAs:	Rotating Savings and Credit Associations
SACCO:	Savings and Credit Cooperatives
SECO:	Swiss State Secretariat for Economic Affairs
SSA:	Sub-Saharan African
UN:	United Nations

CHAPTER ONE

INTRODUCTION

1.1 Background of Study

The delivery of financial services in the form of micro finance to the poor was popularized by the activities of Professor Yunus in Bangladesh in 1972. Yunus started with providing loans to the people who could not access them through the formal processes. This later evolved and led to the establishment of the Grameen Bank dedicated to providing financial services to the unbanked (Yunus, 2008). Today there are different sizes of MFIs worldwide offering needful financial services to the poor. Some of these institutions are very small in size and are community based while a few others have attained growth in terms of scope and size and have developed into banks. According to World Bank (2010), microfinance is largely applied in developing countries as low-rate finance, using the unique technique of group lending as a financial service for the poor. The less fortunate are thus enabled to gain control over their lives and become engines of economic growth provided they put their skills to work.

Microfinance institutions (MFIs) have existed in many forms for decades, but have only recently garnered global attention as a commercially viable activity that can offer real opportunities for micro-entrepreneurs. According to Gomez and Santor (2008), MFIs have expanded throughout the developing and developed world and now serve over 10 million households worldwide. Despite the relative poverty of their clients, MFIs have been able to extend credit to poor households, while still maintaining high repayment rates and financial sustainability. Much of this success has been attributed to MFIs innovative use of peer group lending; the practice of allocating loans to individuals with little or no collateral but with social capital in the form of peers who are also co-applicants and who in many cases are jointly liable (Gomez & Santor, 2008).

Access to credit hence, makes the free market work for the poor rather than against them (Bornstein, 1998). Several studies have shown that inclusive financial systems are associated with better income distribution. Microfinance is considered as one of the distributive mechanisms as studies indicate that it helps ordinary people and the poor access financial services and hence gain the ability to escape poverty though building more-inclusive financial systems and providing finance to underserved or excluded from the financial system (Basu, 2006).

FinAccess(2009) survey states that MFIs, even though still a small actor in the Kenyan financial sector, have doubled their outreach from 1.7% in 2006 to 3.4% in 2009. The gross loan portfolio has also continued to grow from 1.1 million USD in 2009 to 18.5 USD in 2012. In developing countries, the growth of microfinance institutions (MFIs) which specifically target low income individuals are viewed as potentially useful for promotion of financial inclusion. Even though MFIs at present, mainly offer only credit products; as they grow, they are likely to expand their product range to include other financial services. By partnering with MFIs, mainstream financial service providers could expand their outreach (Shankar, 2013). As such, there is need to focus on how growth of MFIs have contributed to financial deepening in Kenya. As recommended by Yaron(1992) growth will be measured in two score, financial performance (sustainability) and social performance (outreach). Outreach criteria measures MFIs performance in providing financial services to the poor as an outcome and the optimal goal of microfinance intervention. Sustainability measures MFI dependency on subsidies i.e ability to generate it’s on funds to maintain and expand its services without injection of subsidy.

1.1.1: Financial Deepening

Financial deepening is a multidimensional process whereby financial institutions and markets provide a range of services and instruments that allow for efficient exchange of goods and services (e.g., payments services); effective savings and investment decisions, including long maturities; and the financial sector can create a broad menu of assets for risk sharing purposes (hedging or diversification). In other words, it can be understood as a process of increasing the efficiency, depth (e.g., credit intermediation and market turnover), breadth (e.g., range of markets and instruments); and reach (e.g., access) of financial systems (Goyal et al., 2011). As such, deepening can confer important benefits for macro-stability and sustained growth.

According to Goswami and Sharma (2011), financial deepening is often understood to mean that: sectors and agents are able to use a range of financial markets for savings and investment decisions, including at long maturities (access). Conversely, Fullenkamp and Sharma (2009) assert that deep markets allow savers to invest in a broad range of quality investment and risk- sharing instruments and allow borrowers to likewise tap a broad range of financing and risk management instruments. The process of deepening can itself create new risks (e.g., from growing financial interconnectedness, challenges arising from unregulated financial innovation) that must be effectively managed.

To be able to achieve progress, flexibilities in policy and regulatory aspects where rigidities would deter the creation of markets for the previously financially excluded are necessary (Goswami & Sharma, 2011). In addition, Aduda and Kalunda (2012) emphasize that new delivery channels such as agent banking, mobile phone money transfer services, microfinance banks and relaxed Know-Your-Customer (KYC) requirements are needed to reach out the unbanked and underserved. In any case, inclusion requires specialized rules for a specialized market constituency. Thus policies to encourage increased access for the previously unbanked must, however, take into consideration the objectives of financial stability, especially in light of the current economic and financial crisis. They should create opportunities for sustainable development that is able to withstand the various economic shocks (Chibba, 2009).

The Kenya Financial Sector Deepening programme (FSDK), was established with support from DFID in 2005 to stimulate wealth creation and reduce poverty by expanding access to financial services for lower income households and smaller scale enterprises. According to the M4P approach, the programme works with a range of financial institutions, business service providers and support institutions. Kenya's financial services market is relatively well-developed. Competition is strong amongst a diverse group of service providers that have moved deeper into the low-income market over the last five years, in part thanks to FSDK interventions. From 2006 to 2009, overall financial inclusion increased from 58.7% to 67.3%. Gains have come from the introduction of mobile money and the responding rollout of branchless agency banking models by commercial banks competing for the mass market space. Kenyan regulators have also been instrumental in introducing appropriate regulations to facilitate low-income banking and strengthen SACCOs and MFIs. (KPMG, IDAS, 2012)

1.1.2: Microfinance Institutions

Mngolia (2009) defines term microfinance as encompasses the provision-Usually on a small scale-of a broad range of financial services such as deposits, loans, payment services, Money transfers and insurance, to poor and low income households and their enterprises. Conroy, (2003) defines it as the provision of financial services to poor and low income households who don't have ready access to formal financial institutions. Consequently, institutions that offer microfinance are called Microfinance Institutions (MFIs).An MFI is, an institution whose principal business is the provision of microfinance services, including micro credit. MFIs provide financial services using specially designed methodologies that will ensure sustainability for the lenders, and lead to improvement in the standard of life for the consumers, while ensuring a triple bottom-line of developing the person; positively impacting lives.

1.1.2.1. Historical Background of MFIs in Kenya.

Operations of the micro finance in Kenya can be traced to 1984 with the start of Kenya Rural Enterprise Programme (K-Rep) as an NGO support programme for Small and Micro Enterprises founded by World Partners. In 1989 K-Rep changed its services to micro-credit lending which has become its core business since.

Microfinance industry in Kenya is so diverse and its size cannot be accurately estimated. The Association of Micro Finance Institution of Kenya (AMFI) has a total of 59 member institutions serving approximately 6,500,000 (AMFI Website, 2013). The mix market data on the other hand estimates that the number of micro finance clients in Kenya was 10.5 million by 2012. Both AMFI and Mix Market may not be accurate because they do not take into account small and informal players in the field of micro finance. If therefore all players were taken into consideration the number of industry players would be much bigger.

Micro finance players in Kenya are divided into formal, sub-formal and informal sectors of the economy. The informal sector is mainly characterized by small players while the formal sector has large players such as banks and registered institutions. Faith based organizations (FBOs), community based organizations (CBOS), non-governmental organizations (NGOs) and charitable institutions are classified as sub-formal sector and usually they play the role in helping the poor rise to the mainstream. The informal sector basically includes the ROSCAs, ASCAs groups and individual money lenders.

Micro finance continues to play a significant role in the lives of the poor in Kenya. It does this by responding to their needs, concerns and voices by providing easy access of financial services. Nowadays, the industry has changed dramatically, offering the poor a vast amount of financial services and products, including consumer loans, savings accounts, time deposits, micro-insurance and international money transfers. An evidence of this is given by the growth in the number of savers and borrowers from the inception of micro finance to 2009. According to the Mix Market data the population of the micro finance borrowers continued to rise from 0.6 million in 2000 to 1.4 million in 2013 while that of savers rose to 8.7 million in 2013 from 0.09 million in 2000.

1.1.2.2. Regulation of the Microfinance Industry in Kenya

MFIs are regulated by Microfinance Act which was enacted in December 2006.The Microfinance Act brought the regulation on the establishment, licensing and supervision of large microfinance institutions under the control of the Central Bank of

Kenya (Muthuma, 2011 cited by Ochanda,2012). Accordingly the aim of the law was to create an enabling environment that would promote the performance and sustainability of deposit-taking microfinance institutions, while at the same time protecting depositors' interests. By mid-2009, the Central Bank had licensed two large microfinance institutions to become deposit-taking institutions which broadened their mandate from being solely microcredit lenders and allowed them to mobilize funds domestically (Ochanda,2012).

1.1.3: MFIs and Financial Deepening

Financial deepening can be understood as increasing the use and coverage of financial services, both on the savings and the credit side, which requires understanding the needs and characteristics of new consumers, and developing new products and delivery mechanisms. (SECO, 2010).Financial deepening for MFIs involves measuring the depth and breadth of outreach; it involves efficiency of services and level of financial intermediation. Towards this end, MFI's have played a key role in deepening the financial sector in Kenya. This includes, moving from credit only to Deposit Taking Microfinance Institutions (DTM), adopting technology specifically mobile money, widening branch networks to reach the unbanked and increasing financial education.

The Microfinance Act (2006) became operational with effect from 2nd May 2008. The Act enables DTM Institutions licensed by the Central Bank of Kenya to mobilise savings from the general public, thus promoting competition, efficiency and access. It is, therefore, expected that the microfinance industry will play a pivotal role in deepening financial markets and enhancing access to financial services and products by majority of the Kenyans. The DTMs have contributed to the deepening of financial inclusion by opening branches in many parts of Kenya and the region. They have also developed new financial products that are demand driven and that are appropriate to the needs of the clients.(The Standard, August 2013)

Microfinance institutions have also been quick to adopt mobile payments channels, usually to enable the repayment of loans. One institution Musoni Kenya, has decided to operate only through the mobile phone based channel and to make extensive use of technology in its operations. Mobile banking has resulted in a lot of advantages; Clients can repay their loans at their own convenience, both in terms of time and location. Groups no longer have to meet close to a bank branch where they would otherwise bank the repayments. This means that clients can meet closer to their businesses, and reduce the time spent on getting to meetings. More time can be spent by the loan officers in building a relationship with clients, as the time spent on receiving and recording payments is much reduced (Cracknell,2012)

CBK first rolled out the agency model in the banking industry in 2010. In order to enhance the inclusivity of the financial systems, the Central Bank has extended the agency model to the microfinance sector.(Business Daily Africa, December 2011). This will increase the coverage for MFIs making financial services more accessible. According to the AMFI-K, financial education has been a key activity. They educate their members on enterprise development and financial management as a result they have informed entrepreneurs and hence sustainable enterprises.

1.1.4: Financial Sector in Kenya

Financial sector development is recognized as a prerequisite to growth and poverty reduction (Chibba, 2009). Kenya has one of the most dynamic financial sectors in Africa with over 40 banks, over 1500 SACCOs, microfinance institutions, insurance companies, money transfer services, the informal financial services sector comprising of Rotating Savings and Credit Associations (ROSCAs) and Accumulating Savings and Credit Associations (ASCAs) and the Nairobi stock exchange, which is one of the largest in Africa and which is ranked fourth in terms of trading volume (Nzioka 2010). This can be divided into 3 major categories namely: formal, other formal and informal. The formal are regulated, while the other formal are simply registered under law and the informal are unregistered (FSD, 2010)

Over the last few years, the financial sector in Kenya has continued to grow in assets, deposits, profitability and products offering. The growth has been mainly underpinned by; an industry wide branch network expansion strategy both in Kenya and in the East African Community region and automation of a large number of services and a move towards emphasis on the complex customer needs rather than traditional 'off-the-shelf' products. Players in this sector have experienced increased competition over the last few years resulting from increased innovations among the players and new entrants into the market. Agency Banking, MFI's, mobile telephony, DTM's and mobile banks have also gone a long way in extending financial services to millions of poor people at relatively low cost (Aduda and Kalunda,2012)

1.2 Research Problem

Financial sector development is recognized as a prerequisite to growth and poverty reduction (Chibba, 2009). MFIs have been known to provide a channel for increasing the efficiency, depth, breadth and reach (access) of financial systems (Goyal *et al.,* 2011). One of the most pressing issues for Africa is to channel existing resources into the appropriate sectors to stimulate productivity, create employment, provide people and enterprises with basic utilities, and contribute to efficient natural resource management. Microfinance is seen as a solution to include on a large-scale previously excluded poorer groups without access to capital into the financial system so that they may “rise out of poverty” by on their own (Banco, 2006). MFIs information reveals evidence that financial sustainability has an affirmative effect on the depth of outreach, and on the other hand, growth in the depth of outreach enhances the financial performance of an MFI (Mustafa& Saat, 2012.)

However much the government has tried these initiatives, it is reported that many people have no access to financial services because of problems like, lack of collateral security, inadequate information about financial services and fear to lose their property after failing to pay back the loans among others (AMFIU, 2010). KPMG, IDAS report, 2012 claims that microfinance institutions themselves have achieved limited success in sustainably increasing beneficial financial access for the poor. Microfinance has also been questioned for its inability to offer lower interest rates or reach deeper into remote rural markets. This brings the role of microfinance’s in enhancing financial deepening under focus.

Literature on the relationship between performance of MFIs and financial deepening in Kenya is limited. Only a few empirical studies have been conducted on this subject. Kurgat(2011) studied the Role of Savings in Microfinance Institutions. He sought to find out whether savings foster institution’s financial performance and outreach. Ochieng(2012) investigated the effects of microfinance loans on poverty reduction with a case study of K-Rep bank, while Karuri (2010) studied the impact of microfinance services on poverty alleviation at the household level. While the literature offering general statements about microfinance related issues is plentiful, few reports on its role in financial deepening are available. Ramji (2009) notes that despite the attention paid to financial inclusion and policies devoted to enhancing access to finance, there is a dearth of information regarding access to finance.

According to Ramji, this knowledge gap poses a significant challenge in designing effective policy interventions and is worth being addressed. This study therefore examines the role played by the micro finance institutions in enhancing financial deepening in Kenya.

1.3 Research Objective

This study aims to determine how growth of MFIs has contributed to financial deepening in Kenya.

1.4 Value of study.

Microfinance programs and institutions have become an increasingly important component of strategies to reduce poverty or promote micro and small enterprise development. However, knowledge about the achievements of such initiatives remains only partial and contested. Given this state of affairs the assessment of microfinance programs remains an important field for researchers, policymakers, MFIs and development practitioners.

Development practitioners can use this research to come up with future programmes for the alleviation of poverty and promotion of businesses. Donors can use the research to justify their stand on sustainability of projects and emphasis on promotion of MFIs. Scholars can use it as a basis for future research and, it will add to the body of knowledge. Players in the MFI industry can benefit from this study by justifying their demand for subsidies. The study findings may help boost MFIs sector development and investments which is the engine of growth and development.

This research will make a contribution to policy makers and the government in its journey towards attaining vision 2030 .The government can use the study to come up with practical poverty reduction strategies. As the Micro Finance sector grows the government has to come up with regulatory frame- work that will safeguard the interests of all the stakeholders. The study will also provide knowledge on how to empower MFIs through supportive regulatory framework and a better liberalized financial industry.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter discusses the relevant literature on the role of microfinance institutions in financial deepening and it draws literature by several scholars on the topic from across the world. The chapter is organised into the following sub-themes: a review of theories, review of empirical studies, Microfinance institutions and financial deepening. It also has a brief summary of the chapter.

2.2: Review of Theories of Microfinance

The major theories are explained below;

2.2.1: Financial Intermediation Theory

Financial intermediation is seen as the extent to which financial institutions bring deficit spending units and surplus spending units together (Ndebbio, 2004 as cited by Aduda&Kalunda, 2012). An important question that theories try to answer is why do investors first lend to banks who then lend to borrowers, instead of lending directly? Arguments point out to the fact that banks are able to effectively monitor borrowers and thus play the role of delegated monitoring (Diamond, 1984, cited by Aduda& Kalunda, 2012). Diamond shows that reduced monitoring costs are a source of this comparative advantage. Diamond posits that intermediaries provide services by issuing secondary financial assets to buy primary financial assets. If an intermediary provided no services, investors who buy the secondary securities issued by the intermediary might as well purchase the primary securities directly and save the intermediary's costs.(Aduda &Kalunda, 2012).

As stated by the modern theory of financial intermediation, financial intermediaries are active because market imperfections prevent savers and investors from trading directly with each other in an optimal way. The most important market imperfections are the informational asymmetries concerning the savers and investors. Financial intermediaries (as agents and as delegated monitors) fill information gaps between ultimate savers and investors. This is because they have a comparative informational advantage over ultimate savers and investors. They watch over and scrutinise investors on behalf of savers.

Financial intermediation can affect economic growth by acting on the saving rate, on the fraction of saving channelled to investment or on the social marginal productivity of investment. In general, financial development will be positive for economic growth. Transaction cost is the primary factor explaining the presence of financial intermediaries. These costs present the reason for operating the intermediaries (Beston&Smith 1976).

2.2.2: Agency Theory

This is a theory that looks at how to ensure that agents (executives, managers) act in the best interests of the principals (owners, shareholders) of an organization. This happens because of the separation of ownership and control, when the owner of the company or the board of directors (the 'principals') have to employ managers ('agents') to run the business and need to monitor their performance to ensure they act in the owner's interest (Luhman_&_Cunliffe,2012). The main concern of agency theory as proposed by Jensen and Meckling (1976) is how to write contracts in which an agent's performance can be measured and incentivized so that they act with the principal's interests in mind.

Many MFIs were established to reduce poverty and make financial services more accessible to the unbanked and poor. In the early days when MFI started they were financed by donor funds that had a poverty eradication goal. Hence the performance of the MFI was measured on how much MFI reach to the poor (outreach) and impact (how far the lives of those who get financial services are changing as compared to those who don't get these services). But as the MF industry grew in size, the need for increased financing coupled with unpredictability of donor funds triggered the issue of building sustainable MFIs that stand on their own leg i.e. MFIs start covering their own cost of operation from their program revenues. Managers are tasked with the responsibility of building sustainable MFIs and at the same time increase access. This creates an agency problem. This research seeks to show how managers of MFIs have been able to solve this problem and build sustainable organizations and at the same time increase access to finance leading to financial deepening.

2.2.3: Approaches to Microfinance

2.2.3.1. Joint Lending verses Individual Lending

The first wave of theoretical work on microfinance focused exclusively on joint liability. According to Fischer (2010), the term joint liability can be interpreted in several ways, which can be lumped under two categories. First, under explicit joint liability, when one borrower cannot repay her loan, group members are contractually required to repay on their behalf. Such repayments can be enforced through the threat of common punishment, typically the denial of future credit to all members of the defaulting group, or by drawing on a group savings fund that serves as collateral. Second, the perception of joint liability can be implicit. That is, borrowers believe that if a group member defaults, the whole group will become ineligible for future loans even if the lending contract does not specify this punishment. (Fischer, 2010)

Ghatak and Guinnane (1999) review the key mechanisms proposed by various theories through which joint liability could improve repayment rates and the welfare of credit-constrained borrowers. These all have in common the idea that joint liability can help alleviate the major problems facing lenders screening, monitoring, auditing, and enforcement by utilizing the local information and social capital that exist among borrowers. In particular, joint liability can do better than conventional banks for two reasons. First, members of a close-knit community may have more information about one another (that is, each other's types, actions, and states) than outsiders. Second, a bank has limited scope for financial sanctions against poor people who default on a loan, since, by definition, they are poor. However, their neighbours may be able to impose powerful non-financial sanctions at low cost. Several theoretical models confirm that joint liability group lending leads to more and more effective screening, monitoring and enforcement among group members.

While individual lenders disburse loans to individuals, require a larger degree of collateralization, conduct much more screening, and give the largest loans and the best terms. Large institutions in the industry have only recently transitioned to more individual liability loans. Churchill (1999) provides perhaps the best overview of what individual lending at the "bottom of the pyramid" entails. He describes a world of intense client focus, where "character" reports, household cash flows, and business inventory are recorded and analyzed for each client prior to loan approval. According to Lehner (2009) individual loans in microfinance will gain in importance in the future if MFIs continue to get better access to capital markets and if competition further rises.

2.2.3.2: Market Driven Versus Socially Driven Lending

Providers of microfinance services range from tiny NGOs lending in a single rural village, to major microfinance investment funds managed by huge banks and lending in some of the world's largest cities. As such, there are two dominant approaches to providing microfinance (Beaudry, 2008); namely financial systems approach which is market driven and the poverty-lending approach which is socially driven.

The market driven microfinance lending approach focuses on sustainability of the MFIs themselves by paying close attention to the demands of the market. This view is justified by advocates in several ways but broadly they argue that MFIs are most effective when they stick to their core competency of providing financial services (Beaudry, 2008). Furthermore advocates of this approach such as the pioneer of the approach (Beaudry, 2008), believe that lack of credit is the primary structural condition of poverty.

Socially driven microfinance lending approach, also referred to as the 'Credit-Plus' approach focuses more on client sustainability (Beaudry, 2008). Advocates for this approach argue that providing only financial services, including credit, are not enough to eliminate poverty. Beaudry (2008) points out that the approach incorporates and emphasizes the importance of 'economies of scope' as opposed to 'economies of scale' insofar as it strives to maximize the necessary benefits to people instead of maximizing the number of people who can receive the minimum benefits. However, critics argue that where additional services are integrated directly into microfinance programming, this can lead to dependency and greater vulnerability to abuse. For example, individuals who are interested in an MFI's complementary services but who have no need for a loan may end up borrowing in order to access these programs (Zeller et al. 2001).

2.3 Empirical Studies on Microfinance and Financial Deepening

2.3.1 MFIs and Financial Deepening: Making Finance Count for the Poor

In 2006, the Nobel Peace Award was awarded to Mohamend Yunus. Since he founded the Grameen Bank in Bangladesh in the late 1970s, microfinance has experienced an impressive growth. Largely due to the many positive effects attributed to microfinance programmes. Microfinance schemes have been found to reduce poverty and to positively affect nutrition, health and education as well as gender empowerment (Littlefield et al.2003). One of the key roles microfinance has to play in development is in bringing access to financial services to the poor, to those who are neglected by the formal banking sector. Mainstream banks target clients that have collateral. The poor do not have assets to act as collateral, therefore they are ignored by the formal financial sector. These banks tend to be found in urban centres while the majority of the poor in the developing world live in rural areas, where financial services are not provided. (Littlefield and Rosenberg, 2004.) Therefore, if MFIs are to fill this void they must reach the rural poor.

Early financial deepening theories emphasised the need to increase savings in order to stimulate investment and help emerging economies achieve catch-up growth, with poverty reduction to follow. It was quickly overtaken by the global microfinance movement, which promotes the benefits of direct financial service provision to the poor. Many financial inclusion promoters now agree that direct access to finance services can improve individual livelihoods amongst the poor by enabling them to manage scarce resources more efficiently (KPMG, IDAS, 2012).

KPMG IDAS, 2012 report on financial deepening and M4P lessons from Kenya and Rwanda indicate that it is often said that financial inclusion is limited by lack of financial literacy amongst the poor. However, experience on the ground reveals that the poor can be quite discerning consumers. Many of them are already using a variety of products to meet their financial needs. Experience shows that better financial inclusion begins by understanding these existing habits and identifying unmet demand. The report concludes that creating appropriate products, promoting public knowledge, going beyond house hold training and heeding market signals can make finance count for the poor.Savings mobilization is important for improved financial performance and outreach especially in the rural areas where access to financial services is challenging. MFI need to design a range of savings products that are safe and with better returns (Kurgat, 2011)

Ndebbio (2004) examined the financial deepening, economic growth and development: Evidence from selected sub-Saharan African (SSA) countries. The study sought to understand generally what financial deepening (FD) is all about; to determine the appropriate measures of financial deepening by developing some measures of the widest range of financial assets; and to evaluate the impact of financial deepening and other growth related factors on growth in selected Sub-Saharan African countries. He argues that if the increase in the supply of financial assets is small, it means that financial deepening in the economy is most likely to be shallow; but if the ratio is big, it means that financial deepening is likely to be high.

2.3.2: MFIs Performance and Financial Deepening

Performance of an institution is measured from the objectives of the organization angel. Microfinance's goal is to eradicate poverty. In the early days when MFI started they were financed by donor funds that have a poverty eradication goal. Hence the performance of the MFI was measured on how much MFI reach to the poor (outreach) and impact (how far the lives of those who get financial services are changing as compared to those who don't get these services). But as the MF industry grew in size, the need for increased financing coupled with unpredictability of donor funds triggered the issue of building sustainable MFIs that stand on their own leg i.e. MFIs that are able to cover their own cost of operation from their program revenues. Sustainability is loosely defined as the ability of a MFI to cover its operating and other costs from generated revenue and provide for profit. It is an indicator which shows how the MFI can run independent (free) of subsidies. (Ejugu,2009)

According to CGAP (2009), the following five are the basic tools to measure performance i)Breadth of outreach—How many clients are being served?, ii) Depth of outreach—How poor are the clients?, iii)Loan repayment (portfolio quality)—How well is the lender collecting its loans?, iv)Financial sustainability (profitability)—Is the MFI profitable enough to maintain and expand its services without continued injections of subsidies?, v) Efficiency—How well does the MFI control its operating costs?

Waweru & Spraakman (2009) in their study conclude that performance for MFIs is evaluated at individual, division or branch and organizational levels. Consistent with theory (Brignall and Ballantine, 1995; Said et al., 2003; Ittner and Larcker, 1998) .The study further concludes that MFIs have relatively well developed PMS that support their particular businesses both financial as well as non-financial measures of performance.

Financial deepening is measured in terms of access, affordability, diversity of services and financial literacy. It is the process of increasing financial intermediation or engagement within the financial system through savings, sustainability and financial performance. Limited research is available on the relationship between performance of MFIs and financial deepening. This research seeks to establish this relationship.

2.3.3 Microfinance: The Promise; Impact of Microfinance

A global perspective indicates the impression that microfinance is successful in reducing poverty. Many policy makers are therefore engaged on how to make microfinance sustainable and available to many poor households in the future. Many stake holders in the microfinance industry especially donors and investors argue that, "Microfinance can pay for itself, and must do so if it is to reach very large numbers of poor households" (CGAP,2012). The overall message in this argument is that unless microfinance providers charge enough to cover their costs, they will always be limited by the scarce and uncertain supply of subsidies from governments and donors.

Adam and Von Pische (1992) assert that debt is not an effective tool for helping most poor people to enhance their economic condition be they operators of small farms or micro entrepreneurs. However, Adam and Von Pische (1992) point out that there are other more important constraints that face small agricultural households and they include product prices, land tenure, technology, market access and risk. In support of the same view is Gulli (1998) who argues that credit is not always the main constraint for micro enterprises´ growth and development, and that poor people demand a wide range of financial, business development and social services for different business and household purposes.

Studies have shown that micro entrepreneurs below the poverty line experience lower percentage income increases after borrowing than those above the poverty line. Studies have also demonstrated that households below the poverty line tend to use the loans for consumption purposes to a greater extent than households above the poverty line; thus their income should be expected to increase less (Gulli, 1998). Matovu (2006) researched on microfinance and poverty alleviation in Uganda. His objective of study was to examine the impact of microfinance on rural women in Kayunga-Central Uganda. According to research findings, majority of women clients of Uganda Women Finance Trust had registered increased incomes from their microenterprises. From these incomes they were able to solve some problems of poverty like isolation, physical weaknesses and could afford a good diet. They were also able to send their children to school and to pay for their health which is critical for their continued wellbeing and as a consequence break the poverty trap. The findings also reported that clients increased in comes enabled them to save and to buy property. The savings enabled clients to deal with severe crises and to cope up with the shocks and reduce vulnerability and bought property that can be sold also to deal with the crises; savings could be used to acquire another microfinance cycle and also to start and expand the existing micro enterprise activities. In terms of empowerment, majority of women felt that their position in the family had been strengthened, set up businesses and run them, could occupy a political office at local levels and had attained a real change in their lives and self–esteem when they compare themselves to that period before the program. He suggested need for more future research that must focus on a deeper understanding of poverty alleviation performance (Simeyo et.al)

In a way to counter the negative arguments against the impact of microfinance on poverty reduction, other studies have found that microfinance is relevant to poverty reduction not just for the beneficiaries but also there are positive spill over effects to the rest of the community (Khandker, 2006). For example, Khandker's (2006) study uses a panel household survey from Bangladesh and observes that access to microfinance contributes to poverty reduction, especially for female participants, which trickles down to the village level.

Morduch (1999) argues that microfinance has had positive impact on poverty reduction. However he is keen to add that "Even in the best of circumstances, credit from microfinance programs helps fund self employment activities that most often supplement income for borrowers rather than drive fundamental shifts unemployment patterns. It (microfinance) rarely generates new jobs for others and success has been especially limited in regions with highly seasonal income patterns and low population densities (Morduch 1999). Other similar studies have shown that microfinance may be relevant for poverty reduction, but does not reach the poorest as often claimed. The results from these studies identify beneficial impacts to the "active poor" but argue that microfinance does not assist the poorest as it is often claimed mainly because it does not reach them (Sharma 2000, Kiiru and Mburu, 2006). Kiiru (2007) in her study dismisses the notion that lending small amounts normally co-secured by a group is "a positive poverty eradication tool and potentially powerful engine of growth for the economy." Instead, she say, the practice may be condemning millions to abject poverty. The problem, the studies say, is lack of understanding by borrowers on what the loan contract entails and exploitation by microfinance of this ignorance. This group of studies often report mixed results suggesting the possibility of both positive and negative impacts for different households. Coleman (2006) found that microfinance programs have a positive impact on the richer households but the impact is insignificant to the other poorer households.

Another study by Aghion and Morduch (2005) reveals that microfinance can make a real difference in the lives of those served, but microfinance is neither a panacea nor a magic bullet against poverty, and it cannot be expected to work everywhere and for everyone. Much as there have been mixed statistical impacts of microfinance, there also has been no widely acclaimed study that robustly shows strong impacts, but many studies suggest the possibility of good welfare impact (Aghion & Morduch, 2005). More research should therefore be directed towards not just specific results but also the context within which particular results are expected. What worked in a particular socio cultural and economic context may not necessarily work the same if the socio cultural and economic conditions are changed in another context. This kind of focus for future research may contribute more to knowledge in financial deepening in the Kenyan context.

2.4: Chapter Summary

The literature review has discussed theories, review of empirical studies, microfinance institutions and financial deepening. With increasing number of MFIs and dwindling availability of funds from donors, MFIs have to focus on how to be sustainable while increasing access to financial services hence the reason for increase in market driven microfinance lending approach. Literature also shows that group lending approach is the most effective way of including the unbanked and poor into the financial system. The theories of microfinance reveal different theoretical arguments on positive impacts of microfinance and financial deepening. Case studies demonstrate that microfinance can have both positive and negative effects on the lives of the poor, but rigorous quantitative evidence on the nature, magnitude and balance of effects is scarce and inconclusive. MFIs have grown in size and portfolio over the last decade hence making significant contributions towards making financial services more accessible in Kenya. However, significant statistical data on the how growth of MFIs has contributed to financial deepening is Kenya is needed.

CHAPTER THREE
RESEARCH METHODOLOGY

3.0 Introduction

This chapter outlines the method that was used for the study and it adopts the following structure: the research design, the target population, sample, data collection and data analysis. It consists of the steps that were followed, the tools that were used in order to generate, collect, measure and analyse data.

3.1 Research Design

In this study a descriptive survey was used. Descriptive research portrays an accurate profile of persons, events, or situations (Robson, 2002). Surveys allow the collection of large amount of data from a sizable population in a highly economical way. It allows one to collect quantitative data, which can be analyzed quantitatively using descriptive and inferential statistics (Saunders et a1., 2007 cited by Omwenga, 2010). Therefore, the descriptive survey was deemed the best strategy to fulfill the objectives of this study. Robson (2002) points out that descriptive study portrays an accurate profile of persons, events or situation. Descriptive research is the investigation in which quantitative data is collected and analysed in order to describe the specific phenomena in its current trends, current events and linkages between the different factors at the current time. Kimutai(2012) in his study states that descriptive research has been credited due to the fact that it allows analysis of the variables under study using linear regression as long as the sampling units for the study are many.

3.3 Population of the Study

According to Cooper and Schindler (2008), population is referred to as the collection of elements about which we wish to reference. For the purpose of this study, the target population comprised the entire MFI sector in Kenya and specifically members of the AMFI-K (Appendix I).

3.4 Sample

A sample size has a specific level of certainty called the level of confidence. The study adopted a census study approach. According to Donald R. Cooper & Pamela S Schindler (2007) a census is feasible when the population is small and necessary when the elements are quite different from each other.

3.5 Data Collection

The study relied on secondary data from Association of Microfinance Institutions Kenya (AMFIK) 2012 Annual report on MFI Sector in Kenya. This publication was useful because it comprises a representative section of the Kenyan microfinance industry developments and trends over 2009-2011, displaying both aggregate quantitative and qualitative information of microfinance sector operating in the country. Published reports from the Market mix website (www.mixmarket.org) also be used specifically to get data for the years 2007,2008 and 2012. This method of data collection is time efficient and reliable because data is already available. It is reliable because data provided has been verified by independent external auditors.

3.6 Data Analysis

The process of data analysis involved data clean up and explanation. Data analysis was carried out using descriptive statistics. Further quantitative data was fed in the computer and analysed using Statistical Package for Social sciences (SPSS 21). In presenting the study’s findings, frequency tables and charts with varying percentages was used.

3.6.1. Analytical Model

Multiple regressions is a flexible method of data analysis that may be appropriate whenever quantitative variables (the dependent) is to be examined in relationship to any other factors (expressed as independent variable). (coben et.al ,2003 as cited by Kimutai,2012)

Multiple linear regression analysis was used to establish how growth of MFIs (independent variables) contributes to financial deepening (dependent variable). This analysis was based on the model specified as follows:

$$\mathbf{NDt = \beta_O + \beta_1\ ROAt + \beta_2\ Dt + \beta_3\ Lt + \beta_5\ NBt + E}$$

Where:

NDt Number depositors (measure of financial deepening at time T.) This shows the portfolio quality. This variable was used because according to Mohan, 2006 bank deposits enables households to perform important financial functions such as saving money safely outside the house, accessing credit, making loan or premium payments, and transferring money.

T is Time (1, 2…..3 years)

$\boldsymbol{\beta_O}$ is regression coefficient.

$\boldsymbol{\beta_{1...4}}$ are slopes of the regression equation

E is Error term of equation.

The independent variables are **ROAt** the Return on assets (measure of financial sustainability) for MFIs at time t. While social performance will be measured by **Dt** (Average deposits of MFIs at time t in Kenya Shillings), **Lt**(Average Loan portfolio of MFIs at time t in Kenya Shillings), and **NBt**(Number borrowers served by MFIs at time t).All the above variables have been used because they measure access, quality and usage of financial services.

This data model is borrowed from the study conducted by Simeyo et.a l(2011) in their study; Effect of provision of micro finance on the performance of micro enterprises; A study of youth microenterprises under Kenya Rural Enterprise Program (K-REP), Kisii County, Kenya.

3.7. Data Validity and Reliability

According to Franken and Wallen (1993), validity refers to the appropriateness, meaningfulness and usefulness of the specific inferences researchers make based on the data collected while Chava and Davi (1996) define reliability as a measure of the degree to which the research instruments yield consistent results or data after repeated trials.

The researcher used multiple sources of secondary data. In this way, these different sources were cross-checked as confirmation of one another. The Secondary data used was also collected from reliable sources i.e published account and audited by external auditors.

CHAPTER FOUR:

DATA ANALYSIS, FINDINGS AND DISCUSSION

4.1 Introduction

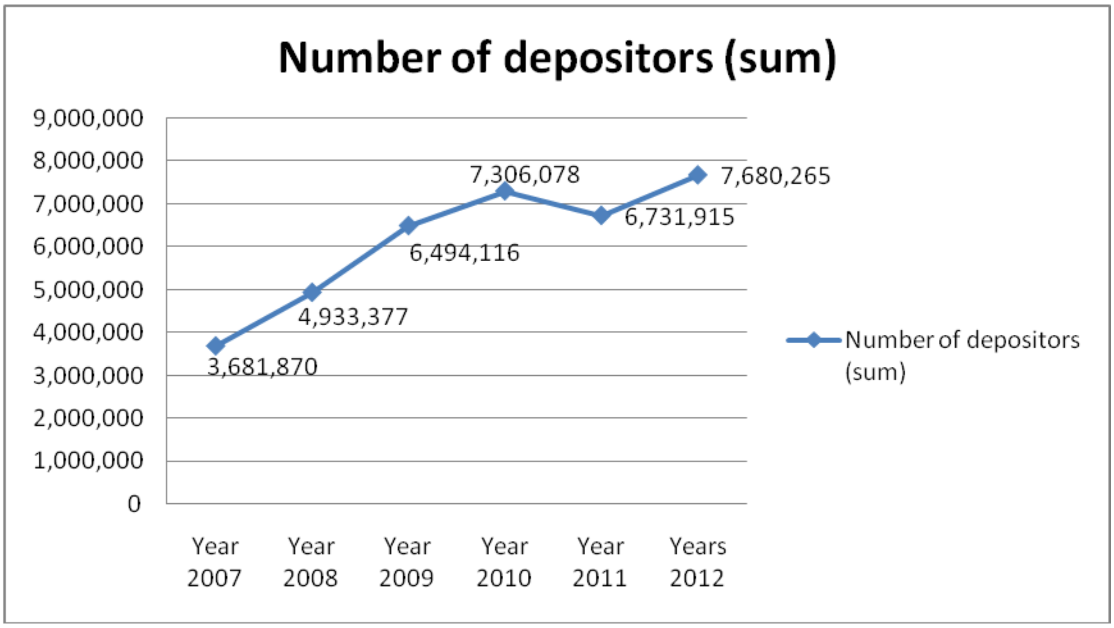
This chapter presents analysis and findings of the study as set out in the research objective and research methodology. The study findings are presented on the role of microfinance institutions in financial deepening in Kenya. The data was gathered exclusively from the secondary source which included the records at the Association of Microfinance Association and mix market report.

4.2 Analysis and Interpretation of findings

4.2.1 Number of Depositors

The study sought to establish the influence of Microfinance Institutions in mobilizing savings through deposits. To achieve this, the study analyzed the trend in the number of depositors. The findings were as illustrated in the figure 4.1 below:

Figure 4.1: Number of Depositors

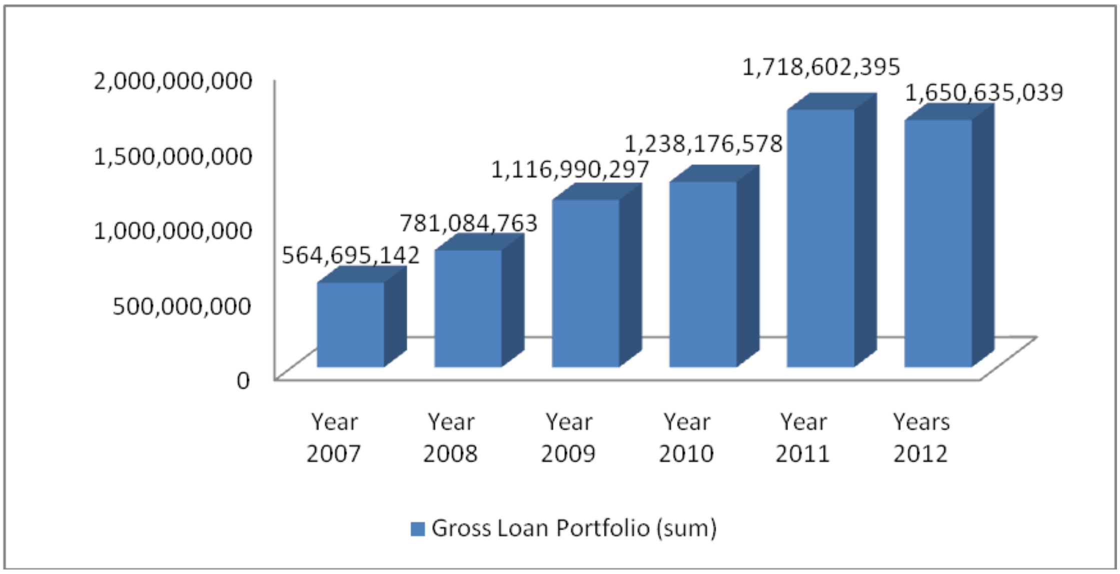


From the findings as illustrated in the figure 4.1 above, it can be established that the number of depositors in the Microfinance institutions grew steadily from one year to another year except for the year 2011 when it declined slightly from 7.3 million to 6.7 million. In the first year of the analysis (2007), the number of depositors stood at 3.68 million which grew to 4.93 million by the end of the year 2008 then increased subsequently for the years 2009 and 2010 to 6.49 million and 7.30 million respectively. However, in the final year of analysis (2012), the number of depositors stood at 7.68 million. From the analysis, the number of depositors grew by over 209% within the study period hence it can be concluded that Microfinance Institutions promoted financial deepening when reviewed from the perspective of number of depositors.

4.2.2 Gross Loan Sum

The study sought to establish the distribution of loan portfolio over the study period. The findings were as shown in the figure below:

Figure 4.2: Gross Loan Sum

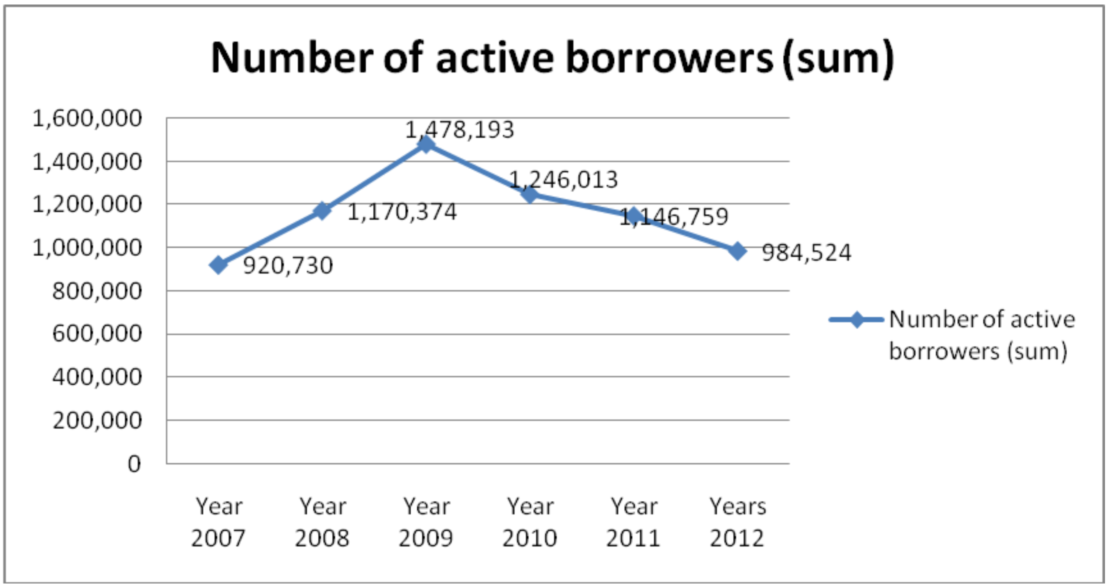


From the study findings illustrated in the figure above, at the onset of the study period, the gross loan portfolio stood at Ksh. 0.56 million. This figure increased for four years consectuvely to stand at Ksh. 0.78 million, 1.12 million, 1.24 million and 1.72 million before posting a decline in the final year of the study period to close at Ksh. 1.65 million. From this analysis, it can be established that the gross loan portfolio grew steadily over the first five years before slowing down slightly in the final year of analsysis. The slow down in the final year of analysis could be attributed to several macro economic factors including high fluctuations in interest rates and general increases in commodity prices which could have lowered the purchasing power of the targeted customers.

4.2.3 Number of Active borrowers

To analyze the role of MFI in financial deepening, the study further sought to establish the distribution and trends in the number of active borrowers throughout the study period. The findings were as illustrated in the figure below:

Figure 4.3: Number of Active borrowers

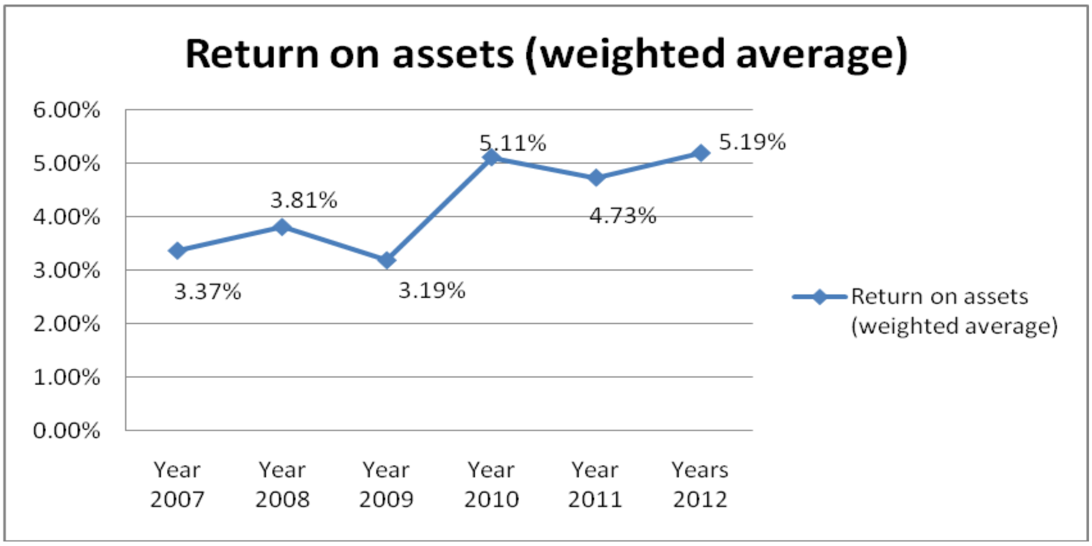


From the study findings, it can be established that the number of active borrowers grew steadily for the first three years before declining continuously for the remaining study period. The number of active borrowers started at 920, 730 in the years 2007, then increased to 1,170,374 by the year 2008, 1,478,193 by the year 2009 before starting a decline in the year 2010 to 1,246,013, 1,146,759 in the year 2011 and finally to close the study period at 984, 524. This analysis shows that the number of borrowers reduced from the year 2009, this could however be attribited to several factors like the conversion of big major MFIs into DTMs. These includes Kenya Womwn Finance Trust,Faulu Kneya and SMEP. These were major MFIs that contributed immensely to the growth of the sector. Their exit could have caused this decline in the active number of borrowers because of new regulations by Central Bank of Kenya and shift in focus in terms of products they offer.

4.2.4 Return on Assets

The study also analyzed Return on Asset in order to measure financial sustainability of MFIs in Kenya over the study period. The findings of the analysis are well illustrated in the figure below:

Figure 4.4: Return on Assets

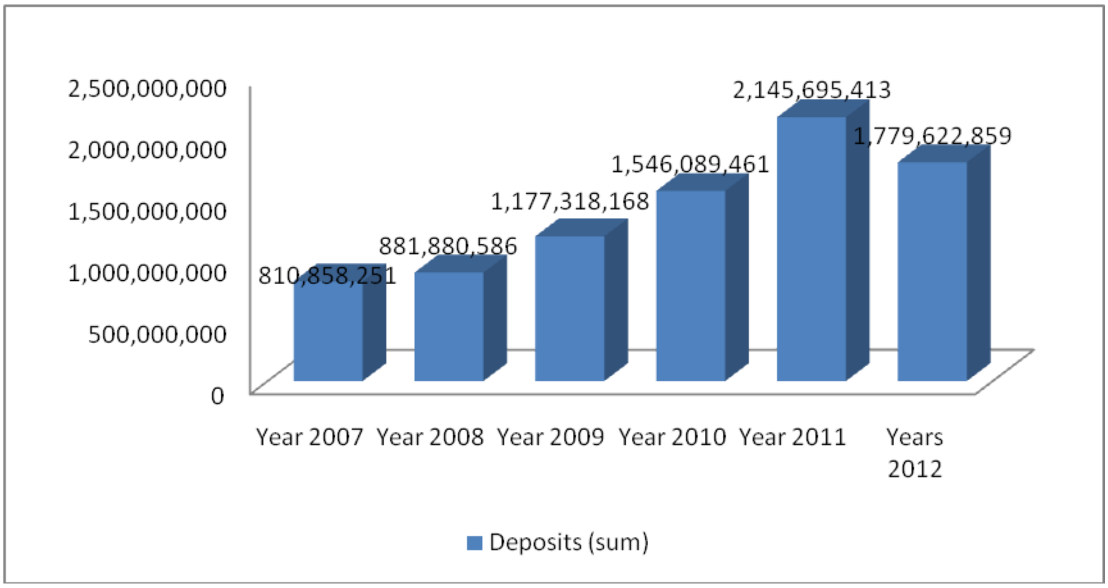


From the findings shown in the figure above, it can be seen that the ROA of MFIs started at 3.37% at the onset of the study period then increased to 3.81% by the year 2008 before declining to 3.19% in the year 2009. ROA however increase in the year 2010 to 5.11% , then reduced sighly to 4.73% in 2011 before hitting an all time high of 5.19% in the year 2012. These findings show that the MFI industry was fairly financially sustainable as its returns on assets were high.

4.2.5 Total Deposits

Financial sector plays an important role in the mediation role by accumulating customers depositing and extending to deficient households as loans in a more efficient manner. the study further sought to analyze the trends in the total deposits collected by MFIs within the study period. The findings were as illustrated in the Figure below:

Figure 4.5: Total Deposits

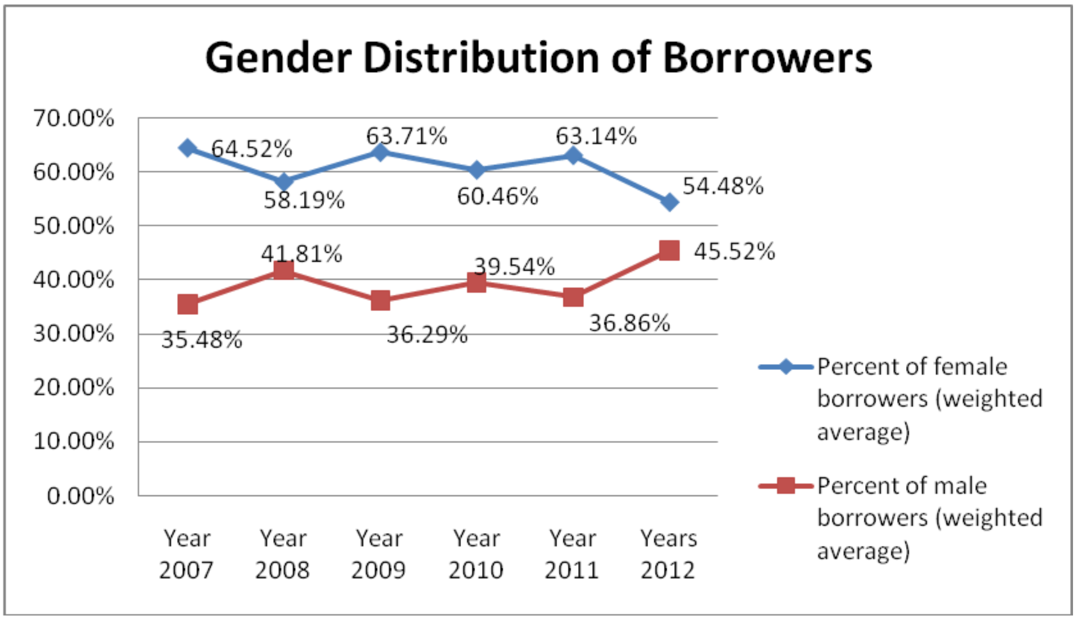


From the study finding, it was established that the deposits grew steadily over the first five years of the study period before declining slightly in the final year. At the onset of the study period, deposits stood at Ksh. 810.86 million, then increased all through as shown above to a high of Ksh. 2.145 billion. The deposits closed the study period at Ksh. 1.8 billions mainly because the MFIcount for 2012 was low. This shows that the MFIs played a key role in their financial intermediation process. They were able to collect money that would otherwise be laying idle with depositors who could not access financial services and channel them into circulation by extending loans.

4.2.6 Gender Distribution of Borrowers

The study further sought to establish the gender distribution of borrowers in the Microfiance sector in Kenya over the study period. The fidnings were as illustrated in the figure below:

Figure 4.6: Gender Distribution of Borrowers



From the study findings, it can be established that there were generally more female borrowers than male borrowers. at the beginning of the study, female borrowers made up 64.52% while their male counterparts comprised of 35.48%

4.2.7 Regression Analysis

In order to show how growth of MFIs (independent variables) contributes to financial deepening (dependent variable), the study conducted a multiple regression analysis. The findings were as shown in the table 4.1 below:

Table 4.1: Model Summary

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.985[a]	.969	.847	598081.912
a. Predictors: (Constant), Amount of Deposits by clients of MFIs(Dt), Return on assets (ROAt), Amount of Loans to clients of MFIs (Lt),Number of active borrowers(NBt)				

Author: Research data (2013)

Coefficient of determination explains the percentage of variation in the dependent variable that is explained by the independent variables. It is used to explain the extent to which changes in the dependent variable can be explained by the change in the independent variables.

From the analysis, the independent variables (Number of active borrowers, amount of deposits by clients of MFIs, return on assets, and amount of Loans to clients of MFIs) in this study contributed to 96.9% of the variation in financial deepening as explained by adjusted R^2 of 0.969.

The study conducted an Analysis of Variance, in order to test the significance of the model. The findings were as shown below:

Table 4.2: Analysis of Variance

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	1.135E13	4	2.837E12	7.932	.0260[a]
	Residual	3.577E11	1	3.577E11		
	Total	1.171E13	5			
a. Predictors: (Constant), Number of active borrowers (NBt), Amount of Deposits by clients of MFIs(Dt), Return on assets (ROAt), Amount of Loans to clients of MFIs (Lt)						
b. Dependent Variable: Financial deepening(Number of depositors)						

Author: Research data (2013)

From the ANOVAs results, the probability value of .260[a] was obtained implying that the regression model was insignificant in predicting the role of microfinance institutions in financial deepening in Kenya was less than α=0.05.

Table 4.3: Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-2905697.613	2758741.185		-1.053	.483
	Return on assets (ROAt)	1007507.345	533686.644	.585	1.888	.310
	Average Deposits by clients of MFIs(St)	-.003	.002	-.902	-1.198	.443
	Amount of Loans to clients of MFIs (Lt)	.004	.002	1.278	1.705	.338
	Number of active borrowers (sum)	2.944	1.586	.382	1.856	.315
a. Dependent Variable: Financial deepening(Number of depositors,NDt)						

Author: Research data (2013)

The researcher conducted a regression analysis so as to determine how growth of MFIs (independent variables) contributes to financial deepening (dependent variable). The following regression equation was obtained:

NDt = -2905697.613+1007507.345ROAt-0.003Dt +0.004Lt + 2.944NBt

From the regression model obtained above, holding all the other factors constant, the financial deepening will be -2905697.613. A unit change in return on assets holding the other factors constant will lead to change the financial deepening by 1007507.345; A unit change in Average deposits by clients holding the other factors constant will change financial deepening by -0.003. A unit change in amount of loans to clients of MFIs holding the other factors constant will change financial deepening by 0.004 while a unit change in Number of active borrowers (sum) of MFIs holding the other factors constant will change the financial deepening by 2.944. This implied that return on assets had the highest influence on the financial deepening followed by, followed Number of active borrowers, then amount of loans to clients of MFIs and finally amount of savings/ deposits by clients.

The obtained regression equation further implied that there was a direct relationship between financial deepening and return on assets, Number of active borrowers and amount of loans to clients of MFIs while there was an inverse relationship between financial deepening and amount of savings/ deposits by clients.

The analysis was undertaken at 5% significance level. The criteria for comparing whether the predictor variables were significant in the model was through comparing the obtained probability value and $\alpha=0.05$. If the probability value was less than α, then the predictor variable was significant otherwise it wasn't. The predictor variables which were insignificant in the model as their probability values were which was greater than α=0.05.

4.3 Summary and Interpretation of Findings

Microfinance is considered as one of the distributive mechanisms that help ordinary people and the poor access financial services and hence gain the ability to escape poverty though building more-inclusive financial systems and providing finance to underserved or excluded from the financial system. The study findings established that number of depositors in the Microfinance institutions grew steadily from one year to another year except for the year 2011 when it declined slightly from 7.3 million to 6.7 million. The data findings established that the number of depositors grew by over 209% within the study period. These findings shows that the MFI had increased their outreach which concurs with the FinAccess (2009) survey which established that small actor in the Kenyan financial sector have increased their outreach.

The gross loan portfolio, as established by the study, increased steadly over the study period but declined at the end of the study period. At the onset of the study period, gross loan portfolio was at Ksh. 0.56. This figure increased for four years consectuvely to stand at Ksh. 1.72 million in 2011 before posting a decline in the final year of the study period to close at Ksh. 1.65 million.

The number of active borrowers grew steadily for the first three years before declining continuously for the remaining study period. The number of active borrowers started at 920, 730 in the years 2007, after which it increased to 1,478,193 by the year 2009 before starting a decline to 984, 524 at the end of the study period. the rising trend in active borrowers over the initial years of the study concurs with the findings of Mix Market data which found out that the population of the micro finance borrowers continued to rise.

The ROA of MFIs remained high over the study period.From the findings, the ROA of MFIs started at 3.37% at the onset of the study period then increased to 3.81% by the year 2008 before declining to 3.19% in the year 2009. ROA however increase in the year 2010 to 5.11%, then reduced sightly to 4.73% in 2011 before hitting an all time high of 5.19% in the year 2012.

The study finding established that deposits grew steadily over the first five years of the study period before declining slightly in the final year. at the inception year, deposits stood at Ksh. 810.86 million, then increased all through to a high of Ksh. 2.145 billion. The deposits closed the study period at Ksh. 1.8 billions. From the study findings, it can be established that there were generally more female borrowers than male borrowers.

A well-developed financial system brings poor people into the mainstream of the economy and allows them to contribute more actively to their personal economic development. MFIs are an important financial intermediary; it provides an answer to financial exclusion. Through the famous group/peer lending approach MFIs have been able to provide financial services to those excluded from the formal financial services. MFIs will be successful in this role if they are able to sustain their operations and at the same time increase outreach and hence increase their client base.(Pitt&Khandker,1998) The study also concludes that MFIs contribute to financial deepening by increasing the total amount deposits per person. This is also in line with FinAccess, 2009 findings.

The research found out that the number of active borrowers has been decreasing over the years under study this could be as a result of high interest rates and lack of training on how to use the funds advanced leading to misuse of money and as a result resentment. This is in line with the conclusions of Ramji(2009) that access does not mean usage, and as such, opening bank account without accompanying training or marketing may simply result in additional costs for MFI without any benefits to the community.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary of the study

The purpose of the study was to determine the role of microfinance institutions in financial deepening in Kenya and specifically to find out how growth of MFIs contributes to financial deepening. This study was carried out using secondary data obtained from AMFI-K 2012 report and data from mix market website.

The study found out that MFIs play a big role in increasing financial deepening in Kenya. It has increased the number of people who access financial services both depositors and borrowers. The study also found out that growth of MFIs impacts positively the access and usage of financial services. The increase in assets (return on assets), loan portfolio and average deposits means that more Kenyans are able to access financial services from the MFIs due to availability of funds. The study further found out the number of female clients is higher than that of men this can be attributed to the fact that most women lack collateral as required by mainstream financial services. This clearly shows that MFIs contribute to financial inclusion of those who would otherwise be excluded. The researcher would therefore like to conclude that MFIs play a crucial role in financial deepening in Kenya and as such should be supported to grow further and reach many people for economic growth.

In general the study shows the benefits of MFIs in the financial sector; it promotes financial deepening. This could be the reason why development agencies have been keen to support MFIs in the past. With increasing numbers of MFIs and more demand for funds, its time the government and players in the financial sector support MFIs to grow, the benefits are enormous. More over the study found out that successful MFIs work on increasing their profitability and savings in order to increase funds meaning they are able to reach more people hence succeeding in two folds; Financially and socially.

5.2 Conclusion of the study

From this study, it can be concluded that there is a positive relationship between growth of MFIs and financial deepening.From the study findings, the study concludes that the number of depositors in the microfinance institution have been increasing over the study period. The study finding further concludes that Microfinance Institutions have promoted financial deepening from the perspective of number of depositors.

The study findings concludes that gross loan portfolio has been on increase 2007 before slowing down slightly in the final year of analysis. The study further concludes that the gross loan portfolio directly affects the financial deepening.

With regard to number of active borrowers, the study concludes that the number of active borrowers has been diclining despite steady growth over the first three years years of the study period. The study further concludes that financial deepening is directly related to the number of active borrowers.

The study concludes that the retuns on assets have been high over the study period. the study further and that the the retaurs on assets were higher on the year of closure compared to the year of of inception hence an increase. The study futher concludes that the MFI industry has been fairly financially sustainable as its returns on assets were high. the study further concludes that returns on assets have a positive im pact on financial deepening

With regard to total deposits, the study concludes that the deposits declined over the final year of the study despite a continous increment over the first five years of the study period. The study further concludes that there is an inverse relationship between financial deepening and the deposits made.

5.3 Policy Recommendations

The study findings established that the MFIs played a key role in their financial intermediation process. They faciliate collection of money from households that have surplus and distribute to households that have a deficit hence improving the level of circulation of money in the country. They collect money that would otherwise be laying idle with depositors who could otherwise not access financial services from mainstream financial institutions and channel them into circulation by extending loans to them. Due to this critical role played by MFIs, the study recommends that policymakers come up with policies that promote the operations of MFIs such as regulations not just for DTMs but the entire sector. This will contribute immensely to the growth of the sector.

The study findings established that there are generally more female borrowers than male borrowers. This could be largely attributed to the fact that women generally have limited collateral for loans. This is due to the fact that MFIs rely more on social collateral as opposed to physical assets. This study therefore recommends that the Government develop MFI friendly policies that would improve their spread across the country to boost financial inclusion and thereby economic development.

The study findings established that the number of active borrowers have been declining over the recent years. Based on the findings that the number of active borowers is directly related to financial deepening in Kenya, this study recomends that the MFIs management put in place measures to increase and retain the number of active borowers and at the same time increase training to their clients.

Lastly,I recommend that there should be policy to ensure that MFIsector regularly report there performance to the AMFI-K.This will enable the MFIsector to better benchmark themselves with the best in the industry globally.This will also result in accurate research findings and hence lead to better performance of the sector.Regular reporting will also result in constant trend analysis and hence better interventions.

5.4 Limitations of the Study

A limitation for the purpose of this study included any circumstance that would other has prevented the attainment of the set research objective. The first limitation to this study involved limited availability of secondary data. Getting consolidated data on the operations of MFIs in Kenya was not an easy task. The researcher had to combine several sources in order to complete the study.

The second limitation involved high level of resistance from the organizations targeted for provision of secondary data. The officers in these organizations were reluctant to give the data thinking that it was meant for other purposes other than academic purposes. The researcher moved to assure them that the data sought would only be used for academic purposes. The target organizations believed this after being given a data collection form from the University of Nairobi.

Another limitation for the study involved limited finances. The finances to allow countrywide collection of data on specific MFIs were not available hence forcing utilization of secondary data which may not be very accurate for the study.

Another limitation involved the high changes that have taken place within the Microfinance sector as more and more MFIs graduate into fully fledged commercial banks. This shifts the dynamics in the sector.

Another limitation included high changes in the macroeconomic factors which may have affected some of the variables used in the study. For example, interest rates in Kenya have fluctuated a lot. This has influenced the borrowers' ability to repay and the amount of loans advanced by MFIs.

5.5 Suggestions for Further Studies

This study concentrated its efforts on the role of MFIs in financial deepeinng in Kenya, based on the economic intergration of East African countries, further studies could be done to establishing how growths of MFIs across the region has contributed to financial deepening in East Africa. This would allow generalization of findings to the whole East African market.

The study further suggests that future study be done on the effect of conversion of major MFIs into on the entire MFI industry in Kenya. Further studies should as well be done on the impact of economic changes on the performance of MIFs.

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APENDICES

Appendix I: List of Microfinance Institutions (Members of AMFI-K)

	INSTITUTION	ADDRESS
1	K-rep Bank Ltd K-Rep Centre,	Wood Avenue P.O BOX 25363-00603 NAIROBI
2	Equity	Bank Equity Centre, Upperhill P.O BOX 75104-00200 NAIROBI
3	Co-operative Bank of Kenya Ltd	Co-operative Hse Building- 4th Floor P.O BOX 48231-00100, NAIROBI
4	Kenya Post Office Savings Bank	Market Lane, Postbank House P.O BOX 30311-00100 NAIROBI.
5	Kenya Women Finance Trust	DTM Upperhill, Kiambere Road P.O BOX 4179-00506 NAIROBI.
6	Rafiki Deposit taking Microfinance Ltd	Elroy Plaza, Tom Mboya Street, P.O. Box 66049 00800 NAIROBI
7	Faulu Kenya	DTM Ngong Road, Ngong lane P.O BOX 60240-00200 NAIROBI
8	SMEP	DTM Kirichwa Road, Kilimani P.O BOX 64063 NAIROBI
9	Remu DTM Ltd	Finance House, 14th Floor, Loita street P.O. Box 20833-00100 NAIROBI
10	Uwezo DTM Ltd	Park Plaza, Ground FloorP.O. Box 1654-00100 GPO NAIROBI
11	Century DTM Ltd	New Pumwani Road K K Plaza, Gikomba
12	Sumac Credit DTM	Ltd Consolidated Bank Building, Koinange Street, 2nd Floor P.O. Box 11687-00100 NAIROBI
13	K-Rep Development Agency Ltd	K-Rep Centre| 7th Flr. Wood Av. Kilimani P.O. Box Box 10528 – 00100, NAIROBI
14	Blue Limited Chester House	Koinange Street P.O BOX 27749-00100 NAIROBI
15	Jitegemea Credit	Scheme Jogoo Road, KCB building P.O BOX 46514, NAIROBI
16	One Africa Capital	Ltd Koinange Street-Ratansi Educational Trust Building, 2nd Floor P.O. Box 74093-00200 NAIROBI
17	Canyon Rural Credit Ltd	Studio Hse,3rd floor P.O. box 46532-00100 NAIROBI
18	Nairobi Yehu Microfinance Trust	Buxton Tom Mboya Street P.O BOX 82120 NAIROBI
19	Fusion Capital Ltd	ACK Garden house, Wing A, Ground Floor, 1st Ngong Avenue, Community next to Ardhi House
20	Opportunity Kenya	Geomaps Centre-Matumbata rd Upper Hill P.O BOX 19497-00202 NAIROBI
21	KADET	Capital Hill, Cathedral Road Community

		P.O BOX 1676-00200 NAIROBI
22	BIMAS	Bimas Complex P.O BOX 2299 EMBU
23	SISDO	Ngong Road, Ngong lane P.O BOX 76622-00508 NAIROBI
24	Micro Africa Ltd	P.O BOX 52926 NAIROBI
25	Eclof Kenya	Chiromo, Royal Offices, Mogotio Road P.O BOX 34889 NAIROBI
26	Youth Initiatives – Kenya (YIKE)	Kariobangi North, Sanoda Hse, 2nd Flr P.O. Box 50622-00200,NAIROBI
27	AAR Credit Services	Methodist Ministries Centre, 1st Floor Oloitokitok Road
28	Agakhan Foundation Microcredit Programme	Mpaka plaza, Westlands 3rd floor P.O BOX 13149-00100, NAIROBI
29	ADOK TIMO	Sifa House, Ground Floor, Mission Rd.. Opposite Kibuye Market. KISUMU.
30	Pamoja Women Development Programme	Kikinga House, Kiambu Town P.O. Box 2472 – 00100 NAIROBI
31	Juhudi Kilimo Co.Ltd	Mucai Road, Ngong Road P.O. Box 10528-00100 NAIROBI
32	Musoni Kenya Ltd	Cape Office Park, Opposite Yaya Centre P.O. Box 25351-00100 NAIROBI.
33	Nationwide Credit Kenya Ltd	Trishul Towers, Next to Paramount Plaza P.O. Box 41873-00100 NAIROBI.
34	Fountain Credit Services Ltd	Ngong Road , near Kobil Petrol Station P.O. Box 72367-00200 NAIROBI.
35	Milango Financial Services	Rozina Building, Moi Avenue Street P.O. Box 99637-80107 MOMBASA
36	Credit Limited	Equity Plaza (Thika) 2nd Floor P.O. Box 6685-001000 THIKA
37	Molyn Credit Ltd	Bruce House 9th Floor Standard Street P.O. Box 10144-00100 NAIROBI
38	Greenland Fedha Ltd,	KTDA farmers building P.O. Box 30213-00100 NAIROBI
39	Select Management Services Ltd	Kenya Re towers, off Ragati Road P.O. Box 27639, 00506 NAIROBI
40	U&I Microfinance	Ltd 1st Floor,Asili Complex River Road ,Opposite Kampala Coach
41	Taifa Options Microfinance	Finance House, Kenyatta Highway P.O. Box 727, RUIRU
42	Renewable Energy Technology Assistance Programme(RETAP)	Waumini Hse, Westlands 1st Floor P.O. Box 28201-00200 NAIROBI
43	Rupia Ltd	View Park Towers, 10th Floor P.O. Box 2987-00200 NAIROBI.
44	Mini Savings & Loans Ltd Email:	Highway Building, Githunguri Town P.O. Box 874-00216, Githunguri, KIAMBU
45	Samchi Credit Limited	Parklands Plaza P.O. Box 16982-00620, NAIROBI
46	Focus Capital Limited	Donholm Mina Centre

		P.O. Box 2406-00202, NAIROBI
47	KEEF-Kenya Entrepreneurship Empowerment Foundation	Mapa House 3rd Floor Kiambu Road P.O. Box 648 KIAMBU
48	Women Enterprise Solutions	Development House, Moi Avenue P.O. Box 4083-00200, NAIROBI
49	Springboard	Capital Kensia House along Muranga road, P.O. Box 23720-00100, NAIROBI
50	Indo Africa Finance	Museum Hill Centre 3rd Floor, Museum Hill P.O. Box 39435-00623 NAIROBI
51	Biashara Factors	Finance House, 11th Floor, Loita Street P.O. Box 66065-00800 NAIROBI
52	Platinum Credit Limited	2nd floor, union towers, moi avenue P.O. Box 73304-00200 NAIROBI
53	Ngao Credit Ltd	2nd Floor NHIF Bldg. Community P.O. Box 60776-00200 NAIROBI
54	CIC Insurance	CIC Plaza, Mara Road P.O Box 59485-00200, NAIROBI.
55	Chartis Insurance Company Ltd.	Chartis House, Eden Square Complex, P.O Box 49460-00100, NAIROBI
56	Microensure Advisory Services	Hughes building, Kenyatta avenue, 8th floor P.O. Box 13383-00100, NAIROBI.
57	MESPT	2nd flr vision towers muthithi rd, westlands P.O. Box 187 Sarit Centre 00606 NAIROBI
58	Jitegemee Trust	K-Rep Centre, Wood Avenue P.O BOX 21768-00505 NAIROBI
59	OIKOCREDIT	Methodist Ministries Centre, P.O BOX 67181 NAIROBI

Source: AMFI-K Website(www.amfikenya.com)

Appendix II: Authority Letter to collect Data

UNIVERSITY OF NAIROBI
SCHOOL OF BUSINESS
MBA PROGRAMME

Telephone: 020-2059162
Telegrams: "Varsity", Nairobi
Telex: 22095 Varsity

P.O. Box 30197
Nairobi, Kenya

DATE 24/09/2013

TO WHOM IT MAY CONCERN

The bearer of this letter MERCY CHEBOTICH CHEPKOROM

Registration No. D61/67680/2011

is a bona fide continuing student in the Master of Business Administration (MBA) degree program in this University.

He/she is required to submit as part of his/her coursework assessment a research project report on a management problem. We would like the students to do their projects on real problems affecting firms in Kenya. We would, therefore, appreciate your assistance to enable him/her collect data in your organization.

The results of the report will be used solely for academic purposes and a copy of the same will be availed to the interviewed organizations on request.

Thank you.

UNIVERSITY OF NAIROBI
SCHOOL OF BUSINESS
24 SEP 2013
MBA OFFICE
P.O. Box 30197 - 00100, NAIROBI

PATRICK NYABUTO
MBA ADMINISTRATOR
SCHOOL OF BUSINESS

Appendix III: Letter of Introduction

Alex Gabriel

Association of Microfinance Kenya(AMFI)

Nairobi.

Dear Alex,

<u>RE: REQUEST FOR DATA</u>

As part of the requirement for the degree of master of business administration (MBA) of the school of business, University of Nairobi, I am currently undertaking a research. The aim of the research is to find out "The role of Microfinance Institutions in Financial Deepening in Kenya". Your firm is best suited for this study. I would therefore like to request for your assistance in providing data on the overal performance and growth trends of MFIs in Kenya from 2008-2012 to enable me complete the research .Specifically answering the following questions:

i)The branch networks(the trend in growth of number of branches) for MFIs.

ii)The average size of total loans in KES.

iii)The average size of total deposits in KES

iv)The number of total active borrowers

v)The number of total depositors.

vi)Average Return on Assets for the MFI industry (Asset size and profitability)

Your cooperation will be highly appreciated. The information you provide will be handled with the highest confidentiality and will be purely for academic purposes. A copy of the research report will be made available at your request. Find attached an authority letter to collect data from the University.

Thank you in advance.

Mercy Cherotich Chepkorom