

**THE RELATIONSHIP BETWEEN FINANCIAL
SUSTAINABILITY AND OUTREACH OF MICROFINANCE
INSTITUTIONS IN KENYA**

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DECLARATION

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

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This project has been submitted for examination with my approval as university supervisor.

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DEDICATION

This research project is dedicated to my family for giving me the motivation to seek greater heights academically.

ABSTRACT

Microfinance institutions have grown in the last few years and are now under the spotlight of development experts due to their stellar performance in making credit access to the poor easier. However the performance of MFIs is based on the two concepts, outreach and sustainability. MFIs indeed need to be self-sustaining if they are to achieve their outreach goal of providing financial services to the poor. The objectives of this study were to identify the levels of financial sustainability, assess the levels of depth of outreach of the microfinance institutions in Kenya and establish the relationship between sustainability and outreach.

This study adopts a descriptive survey design approach to identify what levels of financial and depth of outreach has been achieved. A sample of 30 MFIs was selected. Regression model was also used to establish the relationship between sustainability and outreach.

The findings of this study portray that the increase in branches, average number of active clients and the high percentage of women clients has enabled achievement of a greater depth of outreach. This greater depth of outreach has then greatly influenced the financial sustainability of MFIs. It also shows a positive correlation between outreach and financial sustainability. Finally the study concludes that there is a strong relationship between financial sustainability and outreach of MFIs in Kenya.

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LIST OF ABBREVIATIONS

AMFI:	Association of Micro Finance Institutions
CGAP:	Consultative Group to Assist the Poor
ECLOF:	Ecumenical Loans Fund
FI:	Financial Institutions
FSA:	Financial Services Association
FSS:	Financial Self-Sufficiency
GDP:	Gross Domestic Product
KPSOB:	Kenya Post Office Savings Bank
K-REP:	Kenya Rural Enterprise Program
KSTES:	Kenya Small Traders and Entrepreneurs Society
KWFT:	Kenya Women Finance Trust
MFIs:	Micro Finance Institutions
MSEs:	Micro and Small Enterprises
NGOs:	Non-Governmental Organizations
OSS:	Operational Self-Sufficiency
ROA:	Return on Assets
ROE:	Return on Equity
ROSCAs:	Rotating Savings and Credit Associations
SACCO:	Savings and Credit Cooperative Society
SDI:	Subsidy Dependence Index
SMEP:	Small and Medium Enterprise Programme

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Most mainstream banks have considered the poor high risk and hard to serve as they often live scattered across remote areas and because the small loans they need are costly to make and maintain (Kota, 2007). Therefore, Sharma (2001) claims, this segment of the population is perceived low profitability and high risk, hence ignored by mainstream financial institutions (FIs), which results in the poor losing on viable investment opportunities and living in poverty due to lack of access to credit.

Once microfinance institutions (MFIs) came into being they provided a variety of services to the poor who were required to be economically empowered. MFIs provide services such as savings, credit, and insurance facilities and found there is a large demand

for safe and convenient savings by the poor, low-income households and

microenterprises (Sharma, 2001).

Various kinds of risks faced by the poor can be reduced with savings and insurance facilities (Colombage, 2004). MFIs also provide a variety of other services such as skill development training, advisory and counseling services, technical advice and market

guidance constituting a bundle of services referred by Colombage as the “credit plus approach”. Thus microfinance tries to empower the poor by looking further than economic returns.

As MFIs are rather different to traditional FIs in terms of mission and clients the performance is also measured in different ways. Koveos (2004) describes the objectives of these institutions as of a different nature and thus performance assessment also should be different to traditional FIs, measured in terms of both the financial and social dimension. Judgments of performance of MFIs are based on the two concepts, outreach and sustainability (Navajas, Shreiner, Meyer, Gonzalez & Rodriguez, 2000).

1.1.1 Financial Sustainability

Financial sustainability stands for the degree that an institution is capable of generating sufficient revenue from offered services to meet full operating costs. According to Foster, Greene & Pytkowska (2003) there are two levels of financial sustainability: Operational self-sustainability and financial self-sustainability. The first level of financial sustainability is achieved when “the organization earns sufficient income from its own earned revenue sources to cover all administrative or operational expenses but relies on wholly or partially subsidized capital base”.

Sharma (2001) stresses on the importance of viability as it is critical for expanding outreach to achieve the primary objective of reaching the poorer segments of society. For an MFI to be sustainable, Sharma states that the institutional development support should

encompass ownership and governance, diversified products and services, management information systems, accounting policies and practices, management of portfolio quality and growth, systems, procedures and financial technology for reducing transaction costs, and finally training facilities. Similarly factors such as risk management, well trained human resources, proper pricing, savings mobilization, efficient operations, and vision according to Seibel (1999b) are factors that need to be given adequate attention for MFIs to be viable.

Koveos (2004) stresses the importance of a transparent and simple system of governance that oversees the responsibilities and rights of clients. Therefore such factors can contribute to financial sustainability and viability, but in order to maintain these, MFIs may incur high costs. Financial sustainability may require higher interest rates and more diverse loan portfolios that include larger loans and loans to more affluent borrowers that can compensate for higher transaction costs. Sustainability has been viewed as not an end in itself but rather as a means to an end to social welfare. It has been observed by Morduch (1999) that eventually the sustainable organizations improve welfare, the most, and that unsustainable MFIs inflict costs on the poor in excess of the gains they enjoy. It can be viewed that outreach (end) can be increased through financial sustainability (means).

Financial sustainability may be measured by the following indicators, namely; Operational Self-Sufficiency, Financial Self-Sufficiency, Subsidy Dependence Index, Return on Assets and Return on Equity.

1.1.2 Outreach

Conning (1999) defined outreach via breadth and depth of outreach. According to this definition, outreach is, MFIs extending their financial services to a wider audience, especially towards the poorest of the poor. In contrast to this definition of outreach

Navajas et al. (2000) presented there are six aspects to outreach and they are; Depth-

Value society attaches to the net gain from the use of micro credit by a given borrower;

Worth to users-How much a borrower is willing to pay for a loan; Cost to users- Is the

cost of loan to the borrower. It includes both price and transaction costs; Breadth- The

total number of users; Length- The time frame in which an MFI produces loans; Scope-

Number of types of financial contracts offered by a MFI. In practice the MFI with the best outreach produce both small loans and deposits.

Depth of outreach is described as the value that society attaches to the net gain from the use of microcredit by a given borrower and it usually increases not only social value, but also social costs (Navajas et al., 2000). There are wide differences in the findings of who actually the beneficiaries of microfinance are. Target clients of MFIs have been identified as persons living below nationally defined income based poverty lines, and MFIs should restrict their clientele to that target group according to Seibel (1999a) and the poorest are the bottom half of the poor according to Sengupta and Aubuchon (2008). Therefore the poorest living in abject poverty, differ significantly from the poor (Wijewardena, 2003).

Most institutions have a mission component that shapes the type of borrowers that participate in a given program (Pollinger et al., 2007). It has been found that if MFIs are to reach deeper the MFI must serve a broad spectrum of clients, and not focus exclusively on the poorest and evidence shows that appropriate products and services are the best way of deepening outreach (Fernando, 2004).

Differing findings show that outreach of an MFI may depend on various factors and can even vary, based on type of lending. Cull, Demirguc-Kunt and Morduch, (2007) observed

that outreach for individual lenders depended on size and to a lesser extent age, and that profitability was associated with more. Seibel (1999a) identified that outreach in general depends on governance and source of funds and dependence on grants and loans leaves room for donors to dictate terms. Megicks, Miskra and Lean (2005) found that customer satisfaction was positively related to the performance of Indian Regional Rural Banks in terms of outreach and poverty reduction, and suggest MFIs need to recognize the heterogeneity of the microfinance market. It is interesting to find out if these two aspects outreach and sustainability, of an MFI is mutually exclusive and if there exists any trade-offs in the process.

Outreach may be measured by the following indicators, namely; Total number of clients and percentage of women clients, Number of active borrowers and savers, Average loan size and Distribution of branches.

1.1.3 Financial Sustainability versus Outreach

Kota (2007) stated achieving sustainability while reaching the remote and rural poor who are at the bottom of the income ladder is indeed a challenge. Although, few institutions have gone against the norm and proved it is possible for an MFI to do so. Experience has shown that sometimes it is possible to serve the poor at a significant scale and be profitable in the long run (Kota; Littlefield & Rosenberg, 2004).

Views vary as to whether an MFI can serve the poorest and also be financially sustainable as Fernando (2004) states, three of these are; First camp – Is of the view that

the poorest cannot be reached with financial services on a sustainable basis as they do not have the capacity to service the debt. The major assumptions are that there is very little effective demand for financial services among the poorest, providing such services is very costly, and the poorest cannot afford to pay the prices required. Second camp -

Advocate that the poorest of the poor can be reached not only on a sustainable basis but also on a large scale. The belief is that there is effective demand for credit, which is evident from the reliance of the poor on informal sources. Further, an increasing number of MFIs with a focus on the poorest have achieved successful results. Third camp -

Potential for reaching the poorest on a sustainable and large scale basis is limited, but the search for innovative approaches to expand the outreach to the poorest must be continued.

Hermes and Lensink (2007) described financial systems approach emphasizing the importance of financially sustainable microfinance programs whereas poverty lending

approach focuses on poverty reduction through provision of subsidized interest rate credit.

NGO's also argue that, financial systems approach would divert resources from the social objective of empowering the poorest and the most vulnerable, and MFIs who fail to mobilize their own resources and incur losses decrease rather than increase outreach (Conning, 1999). It has also been observed by Hermes and Lensink (2007) that greater emphasis on financial sustainability and commercialization has shifted the focus from outreach in terms of breadth and depth of clients served by MFIs.

Therefore there still exists a dilemma between financial sustainability and outreach which was aptly described by the fact that an MFI must trade off social performance (including poverty reduction) and financial performance (hence growth potential and future capacity) or find innovative ways of doing both simultaneously (Coperstake, Dawson, Fanning, McKay & Wright, 2005).

1.1.4 The Profile of MFIs in Kenya

Micro finance organizations came to prominence in Kenya in the 1980s, although early experiments date back 30 years in Bangladesh, Brazil and a few other countries (The Microfinance Gateway, 2005). Micro finance has largely been a private (non-profit) sector initiative that avoided becoming overtly political, and as a consequence, has outperformed virtually all other forms of development lending. Kenya's Micro finance industry focuses on delivering financial services to low-income individuals and Micro

and Small Enterprises (MSE's) engaged in non-farm productive activities. Over time MFIs have introduced significant innovations in products and services, which are patronized by MSE's. The Kenya Microfinance sector consists of a large number of competing institutions which vary in formality, commercial orientation, professionalism, visibility, size and geographical coverage. These institutions range from informal organizations e.g. rotating savings and credit associations (ROSCAs), financial services associations (FSAs). Savings and credit co-operative societies (SACCOs), NGOs, to commercial banks that are down scaling (Dondo, 2003).

Over 100 organizations, including about 50 NGOs, practice some form of microfinance business in Kenya. About 20 of the NGOs practice pure micro financing, while the rest practice micro-financing alongside social welfare activities. Major players in the sector include Faulu Kenya, Kenya Women Finance Trust (KWFT), Pride Ltd, Wedco Ltd, Small and Medium Enterprise Programme (SMEP), Kenya Small Traders and Entrepreneurs Society (KSTES), Ecumenical Loans Fund (ECLOF) and Vintage Management (Jitegemee Trust). The Kenya Post Office Savings Bank (KPSOB) is also a major player in the sector but only to the extent of providing savings and money transfer facilities. Many microfinance NGOs have successfully replicated the Grameen Bank method of delivering financial services to the low-income households and MSEs (Mullei and Bokea, 1999).

There has been no specific legislation to govern the MFIs in Kenya until Parliament passed MFI Bill 2006. The MFI Bill 2006 seeks to regulate all deposit taking

organizations which are currently less than 10. In order to promote investor confidence and to assist companies meet stakeholders expectations MFI Bill 2006 has developed a set of guidelines and principles of corporate governance as key to maintaining the trust of the investors (Central bank newsletter 2006).

1.2 Research Problem

As the microfinance industry has evolved and rapidly expanded both globally and in Kenya, questions regarding sustainability and outreach have come to the fore. Microfinance institutions predominantly originated with a mission of social objective which is “poverty reduction”. However, in the last two decades or more there has been a major shift in emphasis from the social objective of poverty alleviation towards the economic objective of sustainable and market based financial services. More specifically, MFIs are expected not only to reach the poor but also to become financially viable. Indeed, MFIs have been increasingly pressured to adapt more “business” practices and to become more self-sufficient (Ledgerwood 1999). The shift in emphasis of MFIs into viable financial institutions while maintaining greater outreach to the poor has given rise to a debate over trade- off between outreach to the poor and financial sustainability.

Majority of MFIs have a dual mission: a social mission - to provide financial services to large numbers of low-income persons to improve their welfare, and a commercial mission -to provide those financial services in a financially viable manner. Micro finance institutions at present are confronted with the challenges of meeting the dual objectives of reaching poor clients (i.e. social objective) and being profitable (i.e. financial objective)

(Morduch, 2000). Other studies have also dealt with the issue sustainability vs. outreach. Cull et al. (2007) provided a new dimension to existing literature in their study which explicitly explored whether there is empirical evidence for a trade-off between the depth of outreach and profitability. They look into this issue by examining whether more profitability is associated with a lower depth of outreach to the poor and the institutional design with respect to the trade-off between financial performance and depth of outreach of microfinance. By running regressions it was found that financial self-sufficiency is not linked to any of the outreach measures and that it lead to the conclusion that pursuit of profit and outreach can go hand in hand.

In Kenya studies focusing on credit rationing (Rukwaro, 2001), determinants of profitability (Kamau, 2008) and factors influencing sustainability (Githinji, 2009) have been done over the last 10 years. However, the relationship between outreach and financial sustainability of microfinance institutions has never been explored. Thus the study is designed to identify levels of financial sustainability and depth of outreach and

find the relationship between financial sustainability and outreach in Kenyan Microfinance Institutions.

1.3 Objective of the Study

The objectives of this study are to:

- i) Identify the levels of financial sustainability of microfinance institutions in Kenya.
- ii) Assess the levels of depth of outreach of the microfinance institutions in Kenya.
- iii) Establish the relationship between sustainability and outreach.

1.4 Value of the Study

The study wishes to contribute to this important sector by informing the MFI regulators and professionals on critical aspects of financial sustainability and outreach to enable them ensure that MFIs become and remain sustainable. It is expected that findings of the study will help MFIs to grow in scale and work toward financial sustainability. The study will also generate valuable empirical literatures which will be used by the researches and scholarly community for advancement of knowledge and basis for future research.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter presents a review of literature that is related to the study. The chapter also describes the theoretical and empirical review of the research report.

2.2 Theoretical Framework

In the past years there have been few studies focusing on the financial sustainability of microfinance institutions and other factors that can influence it. As the MFIs continue to blossom around the world spreading the concept of microfinance in all the continents, researchers are interested to study whether MFIs can be sustainable over time. Some of those institutions have assumed the status of non-profit organisations, concentrating their efforts mostly on the social part of the lending process. These institutions often base their survival on grants, subsidies or aid from those organisations or individuals willing to support them. On the other hand, many entrepreneurs observed the possibility to run a for-profit business, some banks in developing countries extended their services to their wider population that did not have any access to financial services.

2.2.1 Social Capital Theory

In general it is defined as social relations among individuals or groups who are able to develop norms of mutual trust and to form social networks in order to achieve certain social and economic purposes (Putnam, 2000). This definition seems to ignore social context because it assumes every individual or group to have an equal access to join in. In

reality, however, such an assumption is difficult to verify. In order to make the concept of social capital more applicable, Szreter (2002) offers new dimensions, namely bonding, bridging and linking. Bonding and bridging social capital respectively refers to social relations based on homogeneity and heterogeneity of ethnic membership or social class. While linking social capital relates to power that pushes bridging of different social class or ethnicity more pronounced in a society. A society that possesses strong bonding and weak bridging social capital propels the sharpening of class and ethnic boundaries, while, strong bridging and weak bonding social capital supports the rise of rootless elite groups. Therefore, it is necessary to have a balanced development of bonding and bridging social capital in society. Another important aspect that should be taken into account is the idea of the outreach of social capital, something to do with coverage whether at micro, meso or macro level.

They MFIs also mark an important shift in approaches to poverty alleviation, from state-subsidized universal access to credit for male-headed subsistence family farms (through “small farmer” credit programs) to third-sector microfinance institutions targeting poor, rural women as entrepreneurial agents. The “feminization of development” entailed in microfinance is now commonly justified through efficiency and empowerment arguments that draw on the principles of social capital theory. Women in many rural agrarian societies typically lack the collateral, literacy, numeracy, and freedom of mobility necessary to compete for credit from conventional institutional sources. At the same time, women spend disproportionately more of their incomes on household welfare than men and typically exhibit higher repayment and lower default rates (Kabeer 1994). Thus

extending to women credit for small-scale enterprise will likely have beneficial outcomes for all household members, poor communities, and lenders themselves (Morduch 2000). The dominant model of microfinance – the group lending model pioneered by the Grameen Bank in Bangladesh – socializes the costs of lending to poor women by providing them access to credit on the basis of “social collateral” obtained through membership in borrower groups.

Here social capital helps correct for imperfect information about borrowers lacking in formal credit and employment histories and substitutes for collateral by ensuring against default through social sanction and peer enforcement. As the World Bank social capital web page puts it, “poor but closely-knit communities pledge their social capital in lieu of the material assets that commercial banks require as collateral” (World Bank 2001).

Donors thus consider microfinance to be a “win–win” approach to development because investors can mobilize bonding social capital to enhance the financial viability of banking with poor women, and poor women gain access to both social and financial resources that allow them to help themselves through the market mechanism (Mayoux 1995; Fernando 1997; Morduch 2000; Rankin 2001a).

2.2.2 Governance Theory

Ledgerwood (1999) refers to governance as a system of checks and balances whereby a board of directors is established to oversee the management of the MFI. Similarly, CGAP (1997) defines governance as “a system of checks and balances whereby a board is

established to manage the managers. Governance is sometimes conceived as a virtuous circle that links the shareholder to the board, the management, the staff, the customer, and the community at large.” In a more compressed form, Shleifer and Vishny (1997) define governance as “ways in which suppliers of finance to corporations assure themselves of getting a return on their investment”.

Otero and Chu (2002) argue that governance has assumed increasing importance in microfinance because as the MFIs grow in their outreach, the size of their assets (measured by their loan portfolio) also grows to a considerable size. Ensuring effective management of this growth requires an added input and involvement by a board.

Similarly, Mommartz and Schor (2002) observe: “an appropriate credit technology can only be effective if it is used in an appropriate institutional setting (in terms of governance and ownership structure).” In addition, resources must be acquired and combined for production in the most efficient and cost effective way. Thus an effective governance structure is positively associated with sustainability and outreach. They further note that lack of real owners of an MFI does not necessarily result in unstable and risky institutions. They cite the experience of MFIs that span the spectrum from weak to very successful, not so much on account of good governance. NGOs such as Compartmos in Mexico, ACP in Peru, ADEMI in the Dominican Republic, Kenya Rural Enterprise Program (K-REP) in Kenya, ABA in Egypt, RAC and ASA in Bangladesh and Share in India do not have owners and yet have been successful. These arguments suggest that ownership may not be an important issue in performance of an MFI, but governance.

In microfinance the existing evidence linking governance structure to institutional performance, especially with regard to sustainability and outreach, is not widespread, and in most cases are of a general and qualitative nature. For example, Klein (2002) finds that adequate ownership structure, board composition and control mechanisms are essential. The successful MFIs tend to be those that establish clear mission and business objectives at the outset.

In Indonesia Chaves and Gonzalez- Vega (1996) find that the design of institutions that perform financial intermediation matters a great deal, because it determines the performance of the organization and hence its success or failure. In particular, the human element in institution building is noteworthy. Supporting this argument, Klein (2002) notes that it is very important that the management of an MFI is highly professional and remains free of government interference.

2.3 Empirical Review

Bereket and Lalitha (2009) examined a tradeoff between outreach to the poor and financial sustainability based on data on 85 Indian MFIs using correlation matrix. In this regard, the finding of this study does not support a tradeoff between outreach and financial sustainability more specifically the simple correlation between average loan size (proxy to depth of outreach) and operational sustainability is found to be weak. Furthermore, the correlation between number of women borrowers (alternative proxy to outreach) and operational sustainability is also very weak.

However, the study revealed that there is a strong positive correlation between the number of active borrowers (breadth of outreach) and operational sustainability. Further, the data revealed that the majority of the clients of these MFIs about 93 percent are women and indicates that Indian MFIs have good depth of outreach. It is interesting to know that about 82% MFIs they have already reached operational sustainability however, it should be noted that operational sustainability is less rigorous measures of sustainability. In this regard their findings do not support the tradeoff between outreach and financial sustainability more specifically, the correlation between average loan size (proxy to outreach) and operational sustainability is weak. The simple correlation between average loan size and number of women borrowers has shown strong negative correlation which may indicate that women are borrowing small loans. Therefore, it can be concluded that the overall result of the study did not find a tradeoff between outreach the poor and operational sustainability.

Cull et al. (2007) attempts to systematically examine financial performance and outreach in a large comparative study based on a data set of 124 microfinance institutions in 49 countries. Cull et al. empirically investigate whether there is a trade-off between the depth of outreach and profitability of MFIs. Cull et al. (2006) used three dependent variables: FSS, unadjusted measure of OSS and ROA. The results show that MFIs that mainly provide individual loans perform better in terms of profitability, but the fraction of poor borrowers and female borrowers in the loan portfolio is lower than for institutions that mainly provide group loans. The study also suggests that individual-based MFIs increasingly focus on wealthier clients – a process termed as mission drift – whereas this

is less so for the group-based MFIs. Thus, the study by Cull et al. provides evidence for a trade-off between sustainability and outreach and stresses the importance of institutional design in determining the existence and size of such a trade-off. Moreover, Cull et al. (2006) found that institutions that make smaller loans are not necessarily less profitable. Larger loan sizes are associated with lower average costs for both individual-based lenders and solidarity group lenders.

Hermes et al. (2010) provide new evidence on the existence of the trade-off between sustainability and outreach, using data for 435 MFI for the period 1997-2007. In particular, the study focuses on the relationship between cost efficiency of MFIs (as a measure of sustainability) and the depth of outreach measured by the average loan balance, average saving balance and percentage of women borrowers. Cost efficiency of an MFI is measured by using a stochastic frontier analysis. This approach measures cost efficiency in terms of how close the actual costs of the lending activities of an MFI are to what the costs of a best-practice MFI would have been in case it produces identical output under the same conditions. They find strong evidence that outreach is negatively related to efficiency of MFIs. More specifically, MFIs that have lower average loan balances are also clearly less efficient. Moreover, MFIs that have more women borrowers as clients are also less efficient. The results remain robustly significant even after taking into account a long list of control variables.

Locally, Kioko (2012) undertook a study investigating factors influencing financial sustainability of Micro Finance Institution's in Kenya. The study was a descriptive survey targeting a population of 33 MFI's operating in Nairobi governed by the Micro finance Act of 2006. The study found out that MFIs sustainability have been influenced by differentiated services, slacken the requisite for collaterals and beef up of the legal procedures and use financial indicators/ratios like leverage ratios, analysis of arrears rate, analyzing the delinquency of borrowers to mention just a few, to assess, monitor and evaluate market share, credit defaults, non-performing loans and customer loyalty.

Kimando, Kihoro, Njogu, & Wachera (2012) sought to establish the factors affecting sustainability of microfinance institutions operating within the Murang'a Municipality. The study found that financial regulations, number of clients served, financial coverage and volume of credit transacted were the factors that highly affected the sustainability of microfinance institutions. The study concludes that sustainability of MFIs is a function of related and interconnected factors. The study recommends MFIs to open many branches to reach as many people as possible and ensure they conform to rules and regulations.

2.4 Summary

The chapter has presented a review of literature regarding relationship between financial sustainability and depth of outreach of microfinance institutions. The theory of social capital shows society possesses a strong bond which develops social networks in order to achieve social and economic purposes. This social networks lead to balanced development in society and outreach of social capital. Governance theory shows that governance has assumed increasing importance in microfinance because of growth in their outreach.

The empirical review has provided various measures used in determining the relationship between financial sustainability and outreach which include number of women borrowers, size of loans, number of active clients, number of branches, return on assets and operational self-sufficiency. The review also shows mixed results on the relationship between financial sustainability and outreach.

There has been tremendous growth in the MFI industry in Kenya, however there is little literature on the relationship between financial sustainability and outreach. Thus this study seeks to bridge this gap by seeking to establish the level of financial sustainability and depth of outreach of MFIs and the relationship of the two factors based on the Kenyan context.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

The chapter is organized in this manner: first, the research design is discussed followed by the study location. Then, the population of study is given as well as the sample size and the sampling technique. Data collection tools are then presented. Data analysis and reporting completes the chapter.

3.2 Research Design

This study was a descriptive survey. Descriptive survey design is used in preliminary and exploratory studies to allow the researcher gather information, summarize, present and interpret it for the purpose of clarification (Orodho, 2002). Kothari (2003) also recommends descriptive design as it allows the researcher to describe, record, analyze and report conditions that exist or existed. This design will also allow the generation of both numerical and descriptive data that can be used in measuring correlation between variables.

3.3 Population and Sample

The population of interest in this study consisted of all the 30 microfinance that operate within Nairobi (AMFI Directory, 2012). This study was limited to institutions that operate within Nairobi in order to address the influence of location. Therefore, the population of study was 30 institutions which have been identified to be operating within

the area. Since the study is a survey, all the 30 MFIs operating in Nairobi were selected for the study. Thus, there is no sampling of the MFIs to come up with a sample size.

3.4 Data Collection

Secondary data was collected from the MFIs. Secondary data was collected from the financial statements of the MFIs and internal records. This data was used in calculating the financial sustainability.

3.5 Data Analysis

The data was quantitative and was analysed using Statistical Packages for Social Sciences which offers a wide range of data handling capability. In order to identify the relationship, multiple regression analysis was applied. Multiple regression is not only a technique, but a whole family of techniques which can be used to explore the relationship between one dependent variable and a number of independent variables (Pallant, 2007).

The study was guided by the following regression model as used by Cull et al (2007):

$$Y = \alpha_i + b_1 X_1 + b_2 X_2 + b_3 X_3 + b_4 X_4$$

Where:

Y= dependent variable {(Operational Self Sufficiency (OSS)}

α_i = Constant

b1= Regression coefficient of Percentage of women clients

X₁ = Independent variable Percentage of women clients

b2 = Regression coefficient of Number of active borrowers

X₂ = Independent variable Number of active borrowers

b_3 = Regression coefficient of Average loan size

X_3 = Independent variable Average loan size

b_4 = Regression coefficient of branch distribution

X_4 = Independent variable Branch distribution

CHAPTER FOUR

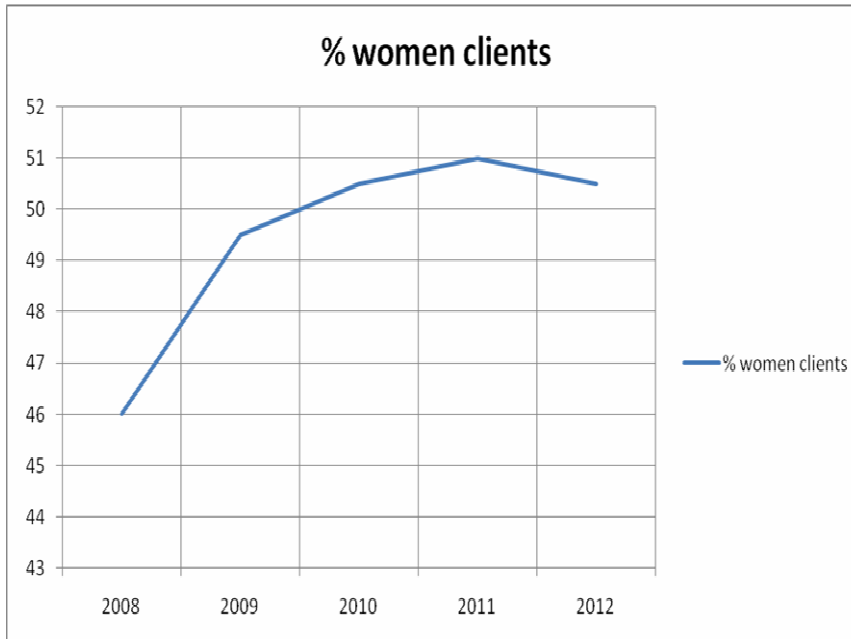
DATA ANALYSIS RESULTS AND DISCUSSION

4.1 Introduction

This chapter presents the data analysis and interpretation of the results. The study targeted a sample of 30 MFIs which were chosen for respondent. Data was collected from 20 respondents which constitute a response rate of 66.7% which was sufficiently representative of the target population. Mean scores and standard deviations and regression analysis was used to analyze the data collected. The raw data was coded, evaluated and tabulated to depict clearly the results of financial sustainability and outreach.

4.2 Summary Statistics (Appendix III)

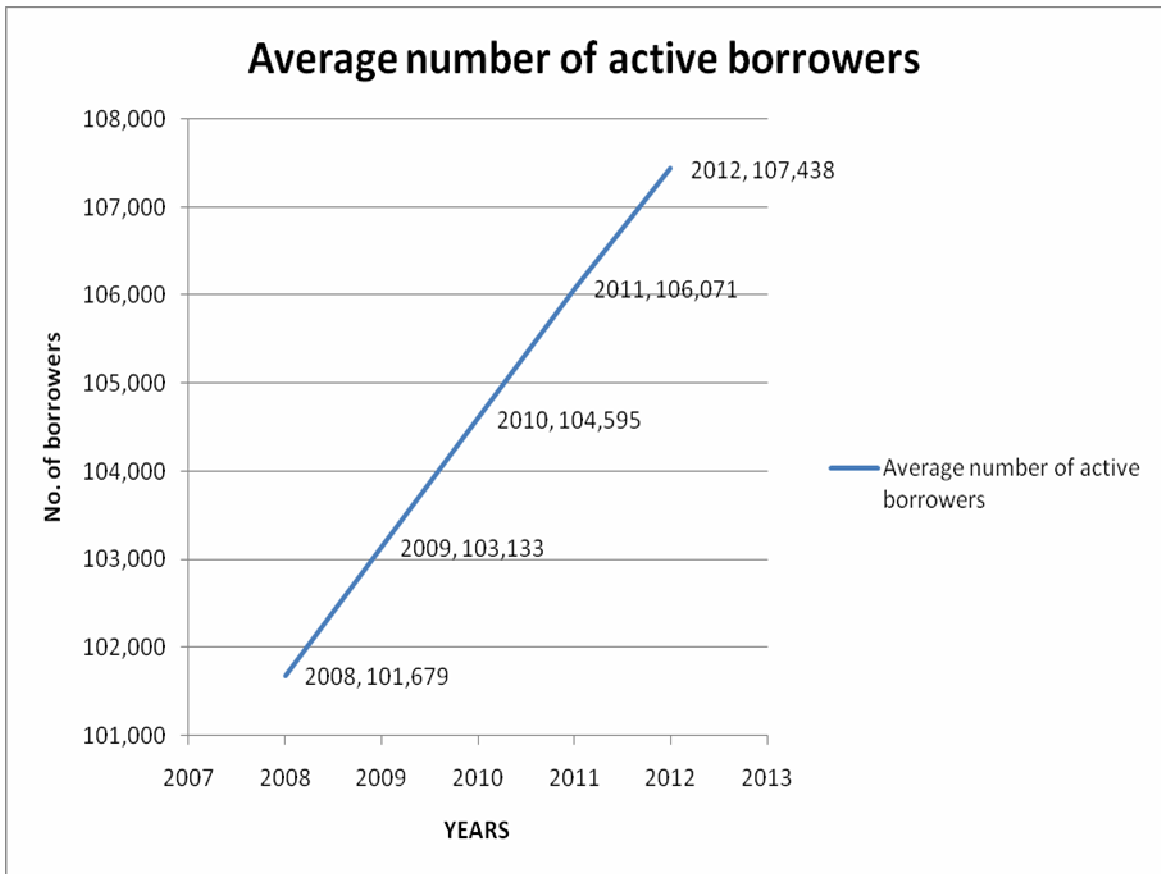
Figure 4.1: Percentage of women clients



Source: Researcher, 2013

From the figure above, it is evident that there has been increasingly steady growth of women borrowers between 2008 and 2009 and there after the percentage of women borrowers grew at a decreasing rate to 2011. The growth of women borrowers was reversed in the year 2012 when there was negative growth.

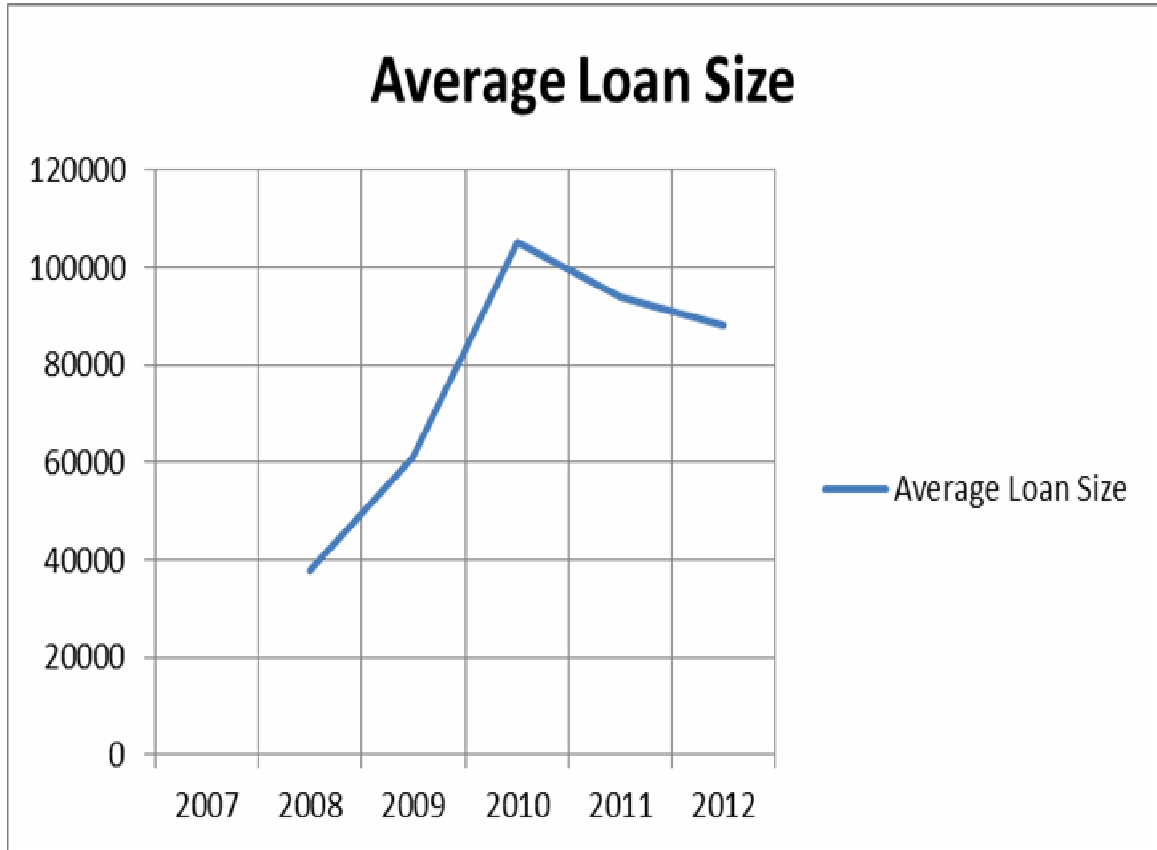
Figure4.2: Average number of active borrowers



Source: Researcher, 2013

From the figure above, the average number of active borrowers for the years 2008 to 2012 has steadily increased. This shows there is increased outreach by microfinance institutions.

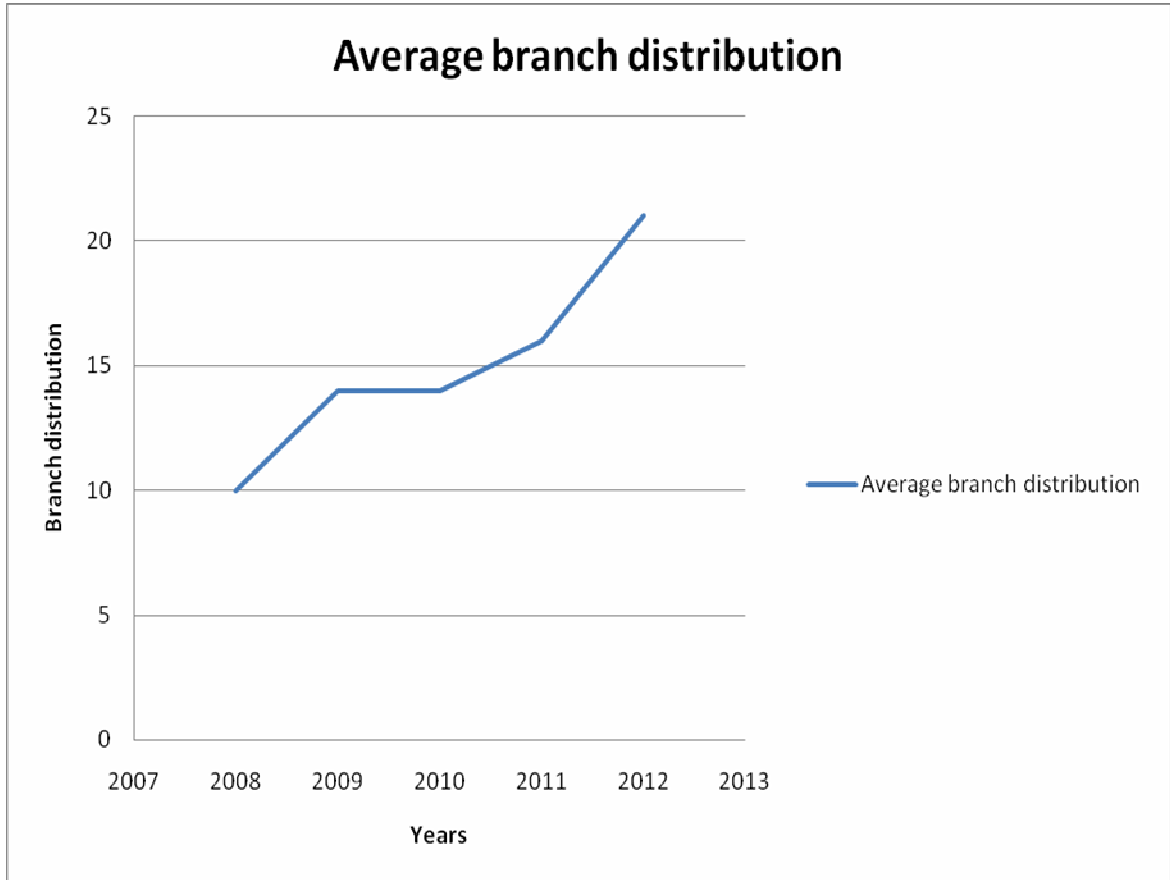
Figure 4.3: Average Loan Size



Source: Researcher, 2013

From the figure above, the loan size for the years 2008 and 2009 was increasing evenly within same two years. In early year of 2009 the loan sizes start to decrease and dropped probably due to high interest rate. In the year 2010, 2011 and continue to reduce though the lending rates were fluctuating making people to shy away to take loans.

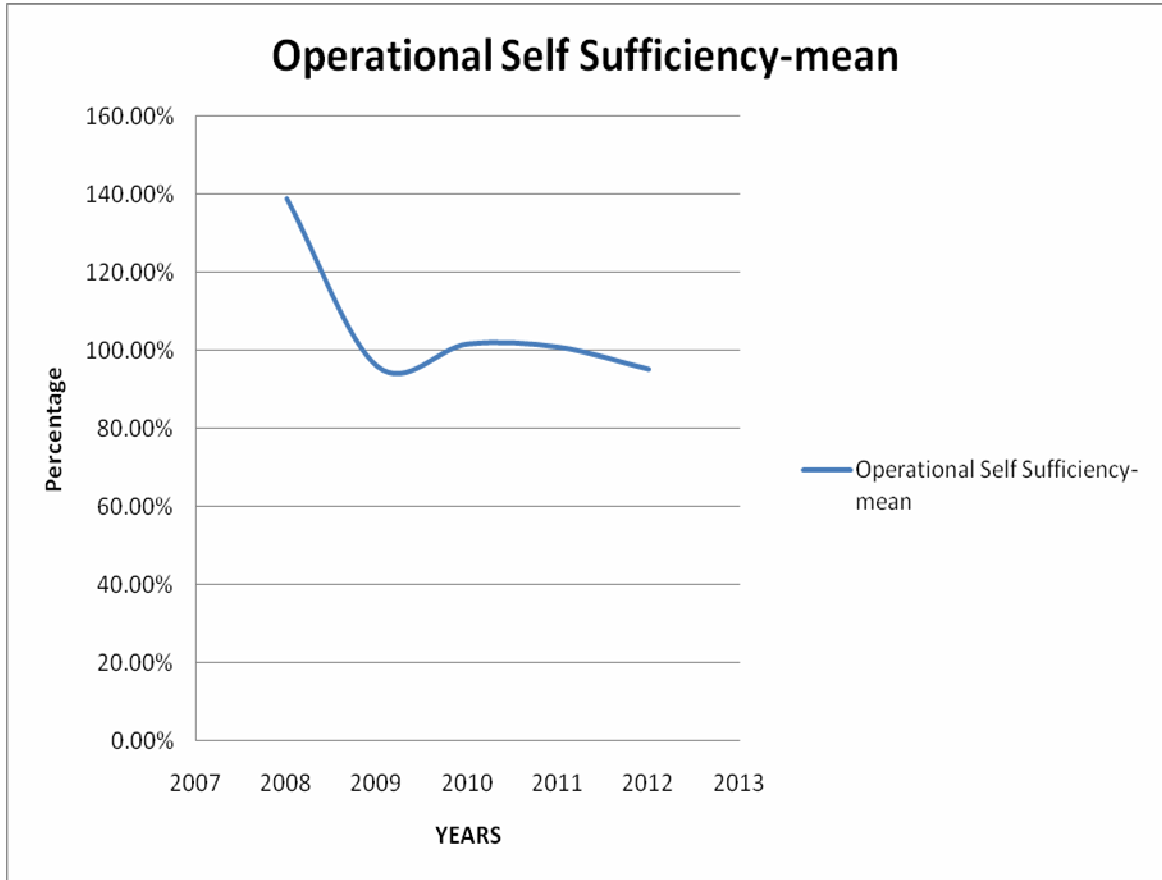
Figure4.4:Average Branch Distribution



Source: Research, 2013

The figure above clearly shows evidence that there has been increased outreach through opening of new branches. There was a steady growth of branch networks between 2008 and 2009. However, the momentum slowed down between 2009 and 2010 after which the branch network continued to grow.

Figure4.5: Operational Self Sufficiency



Source: Researcher, 2013

The figure above shows that the operation self-sufficiency mean has been above 100% most of the years meaning MFIs have generating enough operating revenue to cover operating expenses, financing costs and provision for loan losses. However in the years 2008, 2009 and 2010 the OSS reduced drastically to below 100% and this may be attributed to the post-election violence which may have increased provisions for loans due non repayment of loans. In the year 2011 the OSS recovered to be above 100% but in 2012 the OSS dropped probably due to the high interest rates leading to loan defaults.

4.3 Correlation Analysis

Table 4.1: Pearson Correlation coefficients

		Operational Self Sufficiency-mean	Percentage of women clients(mean)	Average number of active borrowers	Average loan size
Pearson Correlation	Operational Self Sufficiency-mean	1.000	.733*	.712*	.654*
	Percentage of women clients(mean)	.733*	1.000	.536*	.752*
	Average number of active borrowers	.712*	.536*	1.000	.118*
	Average loan size	.654*	.752*	.418*	1.000

Source: Researcher, 2013

The correlation coefficient's are all below 0.8 meaning the data can be relied upon and multicollinearity is not a problem.

4.4 Regression Analysis

Table 4.2: Regression Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.918(a)	.843	.805	.51038	.843	1.242	4	16	.000

Source: Researcher, 2013

The R square the coefficient of determination shows variability in dependent variable explained by the variability in independent variable. This value tells us how operational self-sufficiency varied with percentage of women clients, average number of active borrowers, average loan size and average branch distribution. The R square value of 0.843 implies that 84.3% of the variations in the dependent variable (operational self-sufficiency) are explained by the variations in independent variables (percentage of women clients, average number of active borrowers, average loan size and average branch distribution). This therefore means that other factors not studied in this research contribute 15.7% of the operational self-sufficiency of microfinance institutions in Kenya.

4.4.1 Analysis of variance

Table 4.3: ANOVA

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	93.144	4	23.286	79.730	.000 ^a
	Residual	53.739	16	.292		
	Total	146.884	20			
a. Predictors: (Constant), Percentage of women clients(mean), Average number of active borrowers, Average loan size, Average branch distribution						
b. Dependent Variable: Operational Self Sufficiency-mean						

ANOVA findings (P- value of 0.00) in table 4.4 show that there is correlation between the predictor's variables (Percentage of women clients (mean), Average number of active borrowers, Average loan size, Average branch distribution). An F ratio is calculated which represents the variance between the groups, divided by the variance within the groups. A large F ratio indicates that there is more variability between the groups (caused by the independent variable) than there is within each group, referred to as the error term (Pallat, 2005).

4.4.2 Coefficients of regression

Table 4.4: Coefficients of regression equation

Coefficients						
Model		Unstandardized		Standardized	T	Sig.
		Coefficients		Coefficients		
		B	Std. Error	Beta		
1	(Constant)	.240	.258		.930	.354
	Percentage of women clients(mean)	.494	.077	.297	3.798	.000*
	Average number of active borrowers	.630	.070	.188	3.290	.001*
	Average loan size	.513	.062	.013	.215	.001*
	Average branch distribution	.421	.077	.406	5.445	.000*
a. Dependent Variable: Operational Self Sufficiency-mean						

*** Significant value when Sig Value is less than 0.005**

The established multiple linear regression equation becomes:

$$Y = 0.240 + 0.494X_1 + 0.630X_2 + 0.513X_3 + 0.421X_4$$

The results also show the unique contribution to the explaining of the independent variable. The standard coefficients assess the contribution of each independent variable towards the prediction of the dependent variable since they have been converted in the same scale to show comparison. The results indicate that branch distribution having the highest beta of 0.406 has the largest influence on operational self-sufficiency.

The second most important variable was percentage of women clients with a beta of 0.297. The third most important variable was average number of active clients with a beta of 0.188. The least important predictor of these four variables is average loan size with a beta of 0.013. The t-test statistic shows that all the B coefficients of percentage of women clients, average number of active borrowers, average loan size and average branch distribution are significant.

4.5 Discussion of Findings

The study targeted 30 MFIs in collecting data with regard to the relationship between financial sustainability and outreach of MFIs in Kenya. Data was collected for 20 MFIs which constitutes 66.7% of the target population. Findings of the study show that level of financial sustainability is high as the operational self-sufficiency mean was above 100% apart from 2009 and 2012 when it slightly dropped to below 100% meaning MFIs have been generating more operating revenue to cover operating expenses, financing costs and provision for loan losses.

The levels of outreach are deeper as the study has revealed an increase in number of active borrowers, a smaller average of loan size meaning more poor persons are accessing loans, the percentage of women clients which has over the years reached a high of 51% and the increase in branch network show an increase in the outreach levels of MFIs.

The study findings show that 84.3% of the variations in operational self-sufficiency (financial sustainability) are explained by the variations in percentage of women clients, average number of active borrowers, average loan size and average branch distribution (outreach).

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter presents summary of findings as discussed in chapter four and interpretations of the data analysis, conclusions and recommendations based on the findings. The aim of the study was to find the relationship between financial sustainability and outreach of microfinance institutions.

5.2 Summary of Findings

The objective of this study was to identify the levels of financial sustainability, assess the levels of depth of outreach of the microfinance institutions in Kenya and establish the relationship between sustainability and outreach.

Findings of the study show that level of financial sustainability is high as the operational self-sufficiency mean was above 100% apart from 2009 and 2012 when it slightly dropped to below 100% meaning MFIs have been generating more operating revenue to cover operating expenses, financing costs and provision for loan losses.

The levels of outreach are deeper as the study has revealed an increase in number of active borrowers, a smaller average of loan size meaning more poor persons are accessing loans, the percentage of women clients which has over the years reached a high of 51% and the increase in branch network shows an increase in the outreach levels of MFIs.

The study findings show that 84.3% of the variations in operational self-sufficiency (financial sustainability) are explained by the variations in percentage of women clients, average number of active borrowers, average loan size and average branch distribution (outreach). Thus the outreach factors have greatly influenced sustainability of MFIs to a great extent.

5.3 Conclusions

The study concludes that branches diversification influenced the financial sustainability of MFIs to a great extent. The study also concludes that the increase in number of branches assisted in increasing of the outreach as well as services offered and also setting up branches closer to the people led to increase in number of customers.

The study concludes that the average number of active borrowers is influential in financial sustainability. This active number of borrowers assisted in attracting new customers through word of mouth advertising, improving on the reputation of the organisation, improving financial performance and profitability hence boosting the overall sustainability of the MFIs.

The study concludes that average loan size contributed to increased depth of outreach as the smaller average loan size is an indicator of better outreach to the poor which increased the reputation of the MFIs thus attracting new customers and influencing sustainability.

Also, the study concludes that the percentage of women clients has greatly influenced financial sustainability as this has increased outreach and women are considered to be more disciplined and this help MFIs keep to target on repayment rates. Lastly, the study concludes that there is a strong relationship between financial sustainability and outreach in MFIs in Kenya.

5.4 Recommendations

The study recommends that for MFIs to maintain sustainability, they should further attract new customers through promotions as this would improve MFIs outreach hence improve financial performance and profitability and lowering operating costs hence boosting the overall quality of the MFIs.

The study also recommends that MFIs should open more branches country wide in order to get closer to the people and hence increase the number of customers. The study shows that women access is still limited and thus women access to credit has to be strengthened. Lastly the positive correlation between financial sustainability and outreach implies MFIs could reach more clients which could help them in their social mission and sustainability.

5.5 Limitations of the Study

The study encountered a problem of lack of data from certain MFIs which were not able to provide their financial statements for extraction of information. These institutions do not publish their financial statements as they are not obligated to and are mostly run by individuals who cite competition reasons for non- disclosure.

5.6 Areas for Further Research

The financial sustainability of MFIs can be measured in several ways and by a number of different variables, however only operational self-sufficiency was used in this study as a performance measure of MFIs. So further studies could include more or different dependent variables, it would also be interesting to take a closer look at the effect different independent variables have on the performance.

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APPENDICES

Appendix I: Data Collection Form

Name of MFI	year	Number of Active Borrowers			Number of Branches	Operational Self Sufficiency
			Percentage of Women Clients	Average Loan Size		
	2012					
	2011					
	2010					
	2009					
	2008					
	2012					
	2011					
	2010					
	2009					
	2008					
	2012					
	2011					
	2010					
	2009					
	2008					
	2012					
	2011					
	2010					
	2009					
	2008					

Appendix II: MFIs

1. AAR Credit Services
2. Abakan Foundation-First Micro-Finance Agency (AKF-FMFA)
3. AIG Kenya Insurance Co. Ltd
4. Business Initiatives and Management Assistance Services(BIMAS)
5. Co-operative Bank
6. Co-operative Insurance Company of Kenya Ltd(CIC)
7. Equity Bank
8. Faulu Kenya
9. Fusion Capital
10. Jamii Bora
11. Jitegemee Credit
12. Jitegemee Trust Limited
13. Kadet Ltd
14. Kenya Gatsby Trust
15. Jitegemea Credit Scheme
16. Kenya Post Office Savings Bank (PostBank)
17. K-Rep Bank
18. Small & Micro Enterprise Programme (SMEP)
19. Kenya SNV
20. K-Rep Development Agency
21. SISDO
22. Kenya Eclof

23. Kenya Women Finance Trust (KWFT)
24. Micro Africa
25. Micro Enterprises Support Programme Trust (MESPT)
26. OIKO Credit
27. Plan International Inc.
28. Sunlink
29. Swisscontact
30. Women Economic Empowerment Consort (WEEC)

Source: The Association of Microfinance Institutions (AMFI) Directory (2012)

Appendix III: Summary Statistics Collected

Name of MFI	Year	Number of Active Borrowers	Percentage of Women Clients	Average Loan Size	Number of Branches	Operational Self Sufficiency
	2008	4,219	21.0	2,800,670	1	107%
AAR Credit Services	2009	5,179	31.0	2,580,349	1	108.50%
	2010	5,704	33.0	2,028,932	1	114.80%
	2011	14,487	61.0	4,389,278	1	105.70%
	2012	17,895	82.0	5,786,908	2	103.67%
AIG Kenya Insurance Co. Ltd	2012	196,000	78.0	9,908,000	20	177.90%
	2011	185,778	87.0	15,893,770	10	166.10%
	2010	107,800	43.0	15,000,000	11	133.00%
	2009	125,200	67.0	1,111,100	10	158.50%
	2008	142,575	72.0	10,879,094	5	134.69%
Business Initiatives and Management Assistance Services(BIMAS)	2008	12,252	52.0	1,789,000	4	148.00%
	2009	10,353	32.0	2,632,862	4	91.30%
	2010	9,749	22.0	3,259,591	5	123.00%
	2011	10,221	62.0	4,710,313	7	123.60%
	2012	10,168	43.0	5,890,235	5	165.98%
Co-operative Bank	2008	10,892	34.0	1,000,000	9	106.20%
	2009	21,866	11.0	2,000,000	12	137.03%
	2010	56,980	24.0	3,000,000	18	184.90%
	2011	94,786	56.0	5,000,000	24	166.20%
	2012	101,345	70.0	10,000,000	32	164.30%
Co-operative Insurance Company of Kenya Ltd(CIC)	2008	150,987	88.0	500,000	4	74.3%
	2009	245,000	50.0	1,000,000	5	76.9%
	2010	546,000	20.0	1,500,000	9	77.0%
	2011	600,000	48.0	1,800,000	10	88.90%
	2012	598,000	41.0	2,000,000	17	93.8%
Equity Bank	2008	542,249	40.0	666,890,875	110	145.09%
	2009	715,969	45.0	818,425,218	111	155.10%

	2010	524,902	35.0	924,398,723	120	173.30%
	2011	630,088	33.0	1,278,657,922	131	174.80%
	2012	655,969	51.0	1,657,890,009	133	175.40%
Faulu Kenya	2008	91,105	35.0	30,768,900	26	88.65%
	2009	102,371	47.0	39,659,180	26	91.10%
	2010	85,226	34.0	33,154,112	26	87.70%
	2011	82,328	39.0	38,892,523	26	100.10%
	2012	78,387	44.0	40,897,000	34	81.87%
Jamii Bora	2008	81,989	45.0	1,346,890	1	90.87%
	2009	79,194	42.0	2,675,851	4	91.80%
	2010	45,798	41.0	4,733,595	7	74.00%
	2011	78,908	39.0	4,361,964	11	81.00%
	2012	95,908	37.0	5,000,000	11	84.63%
Jitegemee Credit	2008	5,000	46.0	100,000	1	111.90%
	2009	5,568	52.0	250,000	5	106.80%
	2010	4,000	57.0	300,000	9	115.10%
	2011	6,000	36.0	500,000	15	101.10%
	2012	8,000	47.0	1,00,000	17	107.40%
Kadet Ltd	2008	15,135	78.0	5,778,909	15	65.48%
	2009	17,358	78.0	6,250,423	17	70.60%
	2010	17,559	50.0	6,327,077	11	78.50%
	2011	12,420	50.0	3,761,904	11	69.90%
	2012	15,520	40.0	4,890,876	12	71.11%
Kenya Gatsby Trust	2008	150	69.0	50,000	1	13%
	2009	567	99.0	129,990	1	19%
	2010	1000	80.0	200,000	3	28%
	2011	2678	22.0	500,000	4	27%
	2012	3280	45.0	500,000	5	41%
Jitegemea Credit Scheme	2008	2345	40.0	1,000,000	1	103.66%
	2009	4160	60.0	1,705,311	3	105.10%
	2010	5714	25.0	2,529,346	10	104.70%
	2011	9842	43.0	4,807,457	16	110.20%

	2012	7890	31.0	5,879,000	17	111.78%
Kenya Post Office Savings Bank (PostBank)	2008	10,897	74.0	500,000	19	66.09%
	2009	17,890	76.0	1,000,000	19	75.70%
	2010	22,654	10.0	1,000,000	25	104.70%
	2011	24,890	60.0	5,000,000	25	106.00%
	2012	23,880	11.0	5,000,000	26	88.59%
K-Rep Bank	2008	66,215	32.0	3,841,000	25	89.00%
	2009	67,987	31.0	5,214,000	29	84.40%
	2010	65,073	32.0	6,870,000	30	106.70%
	2011	57,917	23.0	7,501,000	35	116.30%
	2012	45,789	21.0	8,876,000	14	105.74%
Small & Micro Enterprise Programme (SMEP)	2008	36,649	32.0	11,546,987	19	108.32%
	2009	85,678	33.0	12,389,970	20	106.00%
	2010	37,822	32.0	15,605,767	21	103.60%
	2011	52,139	23.0	18,010,135	20	105.10%
	2012	52,055	24.0	20,987,098	20	101.65%
K-Rep Development Agency	2008	1000	61.0	50,985	2	70.50%
	2009	1200	60.0	100,000	8	78.50%
	2010	1590	10.0	250,569	12	59.90%
	2011	1940	80.0	500,000	20	66.60%
	2012	2500	41.0	2,000,000	36	80.90%
SISDO	2008	3,456	73.0	2,765,908	12	122.8
	2009	4,406	57.0	3,183,286	12	129.30%
	2010	7,314	32.0	2,974,694	8	130.40%
	2011	10,522	43.0	3,467,226	9	114.90%
	2012	12,000	39.0	4,324,870	9	103.00%
Kenya Eclof	2008	14,343	29.0	3,903,514	15	107.62%
	2009	16,902	45.0	4,354,884	16	116.20%
	2010	15,513	65.0	4,656,779	16	106.20%
	2011	18,947	43.0	5,269,548	17	101.40%

	2012	17,658	56.0	6,764,890	20	128.01%
Kenya Women Finance Trust (KWFT)	2008	247,532	65.0	133,786,00	3	125.87%
	2009	334,188	54.0	134,293,682	5	124.60%
	2010	413,040	20.0	152,038,345	7	111.90%
	2011	279,850	30.0	134,675,901	14	107.90%
	2012	247,375	52.0	149,000,789	15	122.80%
Micro Africa	2008	1,946	80.0	3,523,349	3	78.90%
	2009	3,225	19.0	2,125,020	5	89.80%
	2010	5,765	20.0	3,060,186	6	122.60%
	2011	9,540	30.0	5,199,822	7	102.20%
	2012	13,845	49.0	7,897,987	9	108.70%