THE EFFECT OF OUTREACH ON THE GROWTH OF MICROFINANCE INSTITUTIONS IN NAKURU COUNTY

BY

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D61/60441/2010

A RESEARCH PROJECT SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE AWARD OF A DEGREE OF MASTER OF BUSINESS ADMINISTRATION, UNIVERSITY OF NAIROBI

OCTOBER 2013

DECLARATION

This research project is my original work and to the best of my knowledge has not been submitted for examination to any other university or college for the award of a degree, diploma or certificate.

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This research project has been submitted with my approval as the University of Nairobi supervisor.

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ACKNOWLEDGEMENT

I thank the Almighty God who made everything possible and for the gift of life itself. I am greatly indebted to my supervisor, Mr Mirie Mwangi, for his tireless effort, sharp mind and for the patience when I knew so little and he knew everything. He still guided and encouraged me. To my family and friends for the support all through and my colleagues who were there when I needed someone to stand in for me during the many days I was required to be away. To my classmates Robertson and Wainaina, am grateful for everything.

DEDICATION

I dedicate this study to my family, especially to my wife Veronica, my constant source of encouragement even when things got tough; to my son Aldrin Kavoo –may you also be motivated to pursue your dreams without fear; and to my dear parents who gave everything within their reach to give us a future, I say you are the greatest pair. To my little sister Dorothy, may this assure you that things are indeed possible with God and determination. To my dear uncle and friend Samuel Mutua, for being such a strong figure in my life, and most importantly for believing in me. Your support can never be repaid, God bless you.

ABSTRACT

As the world economies struggle to drive economic growth by empowering its citizens through financial inclusion among other strategies, Kenya has made great strides in her efforts to reduce poverty and improve the living standards of her majority poor population. This has been made possible through provision of cheap credit through microfinance institutions alongside policies that ensure the financial system strives to include even the traditionally unbanked. The concept of microfinance has changed the banking sector in Kenya with the major commercial banks also providing micro loans to the low end market. The result has been a sporadic growth of microfinance institutions that has increased uptake of microloans by the traditionally unbanked. The objective of this study was to determine the effect of outreach on the growth of these microfinance institutions particularly in Nakuru county that have been integral in the economic growth witnessed in Kenya in recent years. This was informed by the research problem that despite the concerted efforts by the various stakeholders, outreach was still very low despite the huge demand in the country. There also lacked a comprehensive study on the effect of outreach on growth of microfinance institutions especially in Nakuru County, one of the key regions for the socio-economic development of the country, even as the country strives to achieve its goals envisioned in Vision 2030. The study used primary data collected through questionnaires. The questionnaires were dropped at the respondents' MFIs and picked later. The study population comprised of all seven microfinance institutions operating in Nakuru County as at the time of study. Responses were received from five microfinance institutions translating to 71.4% of the target population. The data collected was analyzed using descriptive statistics. The findings of the study revealed that number of clients greatly impacted on the growth of MFIs in Nakuru County and these MFIs placed strong strategies to increase customer numbers. The number of business units or outlets also increased growth by virtue of being able to reach a higher number of clients who would take up loans with the respective MFIs. Another aspect of outreach -value of liability savings/deposits helped the MFIs in the study to advance bigger loans which enhanced growth. These aspects of outreach greatly impacted on the growth of MFIs, that is, they contributed to the increase of assets by these institutions. In conclusion therefore it is apparent that the level of outreach determines to a great extend the rate of growth of any particular microfinance institution and there is therefore a dire need to put in strategies to grow customer numbers, have candid deposit mobilization campaigns as well as try to penetrate the majority rural unbanked population through opening of more branches and agencies. This will ensure financial deepening and inclusion, a key factor in societal emancipation that ensures economic growth. It is recommended that more research be undertaken in the field of microfinance growth and outreach and even in other parts of the country and about how to enhance this outreach so that poverty levels can be reduced. The same is true of empowering majority of unemployed Kenyans who live in abject poverty in this part of the Sahara.

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ABBREVIATIONS

AMFI-Association of Microfinance Institutions

CBK- Central Bank of Kenya

ICT-Information and Communication technology

KWFT- Kenya Women Finance Trust

MFI- Micro Finance Institution

NGO-Non Governmental Organization

PAR- Portfolio at Risk

ROA-Return on Assets

SISDO-Smallholder Irrigation Schemes Development Organization

SMEP-Small and Micro Enterprise Programs

SPSS- Statistical Package for Social Sciences

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Microfinance institutions (MFIs) play a vital role in the economic development of many developing countries. They offer loans and/or technical assistance in business development to low-income community in developing countries (Hartungi, 2007). They have a variety of products including micro loans, savings and other deposit products, remittances and transfers, payment services, insurance, and any other financial product or service that a commercial bank does not offer to low-income clients in the banking system (Hoque and Chisty, 2011).

In Sub-Saharan Africa, microfinance institutions include a broad range of diverse and geographically dispersed institutions that offer financial services to low-income clients, non-governmental organizations (NGOs), non-bank financial institutions, cooperatives, rural banks, savings and postal financial institutions, and an increasing number of commercial banks (Finance Mix, 2010)

1.1.1 Growth of Microfinance Institutions

There is the assumption in that microfinance is already good for the clients, and therefore what is really urgent is to make the financial service available to as many poor people as possible. Morduch (1999) correctly points out that this kind of enthusiasm for microfinance rests on an enticing win-win proposition that: Microfinance institutions that follow the principles of good banking will also be the ones that alleviate the most poverty. The assumption being that with good banking practices it is possible to cover costs and operate in a sustainable manner to continue serving clients and alleviating poverty (Morduch, 1999).

A microfinance institution is said to have grown when there is a net increase in the value of assets over time. This also means that other parameters like net income increase. (Ledgerwood, 1999). The “win-win” situation both for the investor and the poor can be explained as follows: The investor in microfinance programs follows good banking practices with the possibility of some profit, while the poor continue to benefit by accessing reliable credit that is assumed to be beneficial to their welfare. The supporters of the “win- win” proposition stress (mainly by assumption) that the ability to repay loans by the poor is a good indicator that whatever investments the poor make with their micro credit loans must be giving back profits (Bhatt, Gary & Shui-Yan, 2002).

Given the ongoing developments in microfinance, there is considerable interest for many MFIs in Africa to keep pace with the changing landscape in the industry. However, the microfinance industry in most African countries remains largely underdeveloped (Gupta, 2008). African MFIs have continuously faced many challenges including lack of proper regulatory environment and lack of funds. Despite the series of financial sector reforms that the African countries have undertaken since the 1980s, financial systems still exhibit substantial degrees of inefficiencies in their savings mobilization and allocation of resources into productive activities (Woller, 2000). Operating and financial costs are high, and on average, revenues remain lower than in other global regions. Efficiency in terms of cost per borrower is lowest for African MFIs.

The Kenyan microfinance sector began in the late 1960s and has evolved over time to become commercialized, self-sustaining and hugely profitable institutions with over 100,000 clients. Microfinance is also rapidly becoming Kenya's most accessible and affordable financial service due to the very nature of its packaging and collateral substitutability. There has been extensive research on the growth of rural credit lending and the subsidized loan lending by NGOs in Kenya. There is, however, little understanding on the factors affecting the growth of public and private micro finance institutions (Maina, 2011). This is because micro-credit is an effective tool in the socio-economic development of Kenya.

It is therefore important to find cost-effective ways of improving standards while at the same time remaining an important tool for poverty reduction in Kenya. Microfinance institutions (MFIs) target the poor through innovative approaches which include group lending, progressive lending, regular repayment schedules, and collateral substitutes. From a banker's perspective, a microfinance institution is said to have grown when the operating income from the loan is sufficient to cover all the operating costs (Sharma and Nepal, 1997). His performance assessment criteria for the financial viability of any microfinance related financial institution are: repayment rates, operating cost ratio, market interest rates, portfolio quality, and demand driven rural credit system in which farmers themselves demand the loans for their project. In a stable political environment and enabling macro economy, evidence arising over several decades has supported the view that the provision of microfinance in Kenya is an important component of any effort to improve the livelihoods of the poor in society (Beegle, Dehejia & Gatti, 2003).

1.1.2 Outreach

Outreach refers to number of clients served by the microfinance institution (Kareta, 2007). Outreach is an important aspect of microfinance since the fundamental aim of microfinance is to reach the largest number of unserved poor people who cannot access the formal financial services. Limited outreach, therefore can impact on the sustainability in terms of benefits linked to economies of scale. Mayer (2000) notes that for microfinance to attain greater outreach, the MFIs need adequate funding. This funding will facilitate reaching the rural areas where poverty is prevalent. The aspect of funding poses a challenge especially for donor dependent MFIs because these funds are not always available. As such, lack of adequate outreach exposes the MFIs to retard growth.

Mayer (2000) stresses that there is in fact a complimentary relationship between outreach and financial sustainability. He argues that as the number of microfinance clients increase (outreach), MFIs enjoy economies of scale, consequently translating in reduced cost and eventual attainment of financial sustainability or growth. It is of great importance for MFIs to tailor their services in line with the needs of the clients. MFIs that engage in full intermediation achieve rapid outreach and enhance financial returns than those specializing in credit only. (Finance Mix, 2010).

Outreach is central in microfinance activities because it defines the visions of MFIs in improving lives. Managers with limited exposure to credit activities are noted of hindering outreach activities because of poor policy implementation and management which deters customer retention (Jay, 2010). Outreach can be measured in terms of breadth, scope and length. Breadth refers to the number of clients served with financial products which can be traced by total savings volume, number of accounts opened, total loans disbursed and the social economic impact of the loans given out to the client's lives (Finance Mix, 2010). Length refers to the time frame it takes finance institutions to process financial services for customers. The longer it takes the lower the outreach as few clients are served and the MFI are thus unable to recruit and retain more customers. Scope is determined by the number of financial contracts which are offered to clients. The financial services can range from business loan, school fees loan start up loans, savings accounts, home accessibility loans, car leasing and corporate loans depending on the extent to which MFIs managements are creative in developing different products. The higher the scope of services, the greater the outreach to customers since different customers have different desires hence customer retention (Armendariz & Morduch, 2004).

1.1.3 Effect of Outreach on Growth of Microfinance Institutions

According to Morduch (2005) one way that a microfinance institution can attain growth and provide services on a long term basis is to increase viability by improving outreach. This is because the viability of any MFI, as well as the sustainability of its services depends in part, on the volume of internal resources that the MFI can generate, which is a function of the level of outreach achieved by the MFI. Outreach according to Yaron (199) means the extent to which MFIs provide financial services to large number of clients. Outreach is measured by assessing how far micro finance institution has gone to reach those who have been unable to access formal financial services (Schreiner, 2002). The availability of financial services acts as a buffer for sudden emergence business risk, seasonal shrimps or events such as flood or a death in the family that can push a poor family into destitution (Chu, 2008)

Outreach according to Conning (1999) is the effort by MFIs to extend loans and financial services to an ever-wider audience (breadth of outreach) and especially toward he poorest of the poor (depth of outreach). Yaron (1992) suggests alternative sets of measures of outreach as the value of outstanding loan portfolio and the average value of loans extended, the amount of savings and average value of savings accounts, the variety of financial services offered, the number of branches and the annual growth of micro finance institution assets over recent years in real terms. Ledgerwood (1999) classifies outreach measures in three groups namely clients outreach, loans outreach and savings outreach. There is, therefore, a correlation between the level of outreach (value of loans and deposits or savings) and the growth (increase in value of assets) of a micro finance institution.

1.1.4 Micro finance Institutions in Nakuru County

In recent years here in Kenya, there has been renewed interest in microfinance by both policy makers and practitioners. This interest is based on its valued contribution to efforts aimed at improving the livelihoods of the rural population in the country through policies and programs geared towards addressing inequalities arising from the country’s socio-political history. Microfinance refers to all types of financial intermediation services; savings, credit funds transfer, insurance, pension remittances, provided to low-income households and enterprises in both urban and rural areas, including employees in the public and private sectors and the self-employed (Robinson, 2001). In micro-finance, growth can be considered at several levels of institutional, group, and individual and can relate to organizational, managerial, and financial aspects (Rao, 2001). In Kenya, MFIs face an apparent tension between achieving financial growth and contribution to poverty reduction.

As of 2007, the Central Bank of Kenya, CBK reported the existence of 56 micro finance institutions (MFIs) operating in Kenya. Most of these MFIs have branches countrywide, enhancing their outreach to deserving Kenyans, and thus deepening financial inclusion. MFIs in Nakuru County are mostly branches or units whose headquarters are domiciled in the capital, Nairobi Kenya (CBK, 2012). Nakuru County is home to seven of these micro finance institutions and are dispersed in major towns where they have operational footprint. Their operations and functions are strictly determined by the senior management in these head offices. They are also regulated by CBK. The presence of these major MFIs depicts strongly the favorable factors such as the huge cosmopolitan population in the county. Needless to say, the county is well endowed with natural resources such as great arable land, a ready market from the huge workforce in the major flower farms in Naivasha, Gilgil and Nakuru towns. The county's close proximity to the capital Nairobi gives it a first preference for investors due to administrative and operational conveniences.

1.2 Research Problem

Penrose (1959b) in her famous work The Theory of the Growth of the firm outlines the critical roles played by managers and entrepreneurial management teams as interacting with the firm's resources, subjectively perceiving and creating new uses for resources, and driving the rate and direction of the firm's growth and strategic experimentation. As management tries to make the best use of available resources, a truly dynamic interacting process occurs which encourages continuous growth but limits the rate of growth (Penrose, 1959a). The services of resources are upstream from the end product and the catalyst for this conversion process is the resource of management (Mahoney, 1995). While viewing resources as cognitive drivers for strategy, Penrose further notes that there is a close relationship between the various kinds of resources with which a firm works and the development of ideas, experiences and knowledge of its managers and entrepreneurs.

Kagwara (2006) notes that banks and MFIs under her study were involved in credit decisions and this helped the institutions stem credit risk. This then means that adequate skill among staff could greatly help the MFIs to grow. They were also involved in debt management right from origination to delinquent management. Maina (2011) found out that economic factors could be contributing to growth of micro finance institutions in Nyeri District, Nyeri County in Kenya. She further notes that the MFIs reported low turnover and this was grossly below demand. He further observes that internal factors such as resistance to embrace change in ICT, lack of funds to finance modern technology, and an apparent lack of skills among the workforce impacted negatively on the growth of the MFIs. Maina also notes that most of MFIs do not carry out basic research thus denying them a chance to improve on their products and service delivery, get new markets, and learn customer pain points. The management of most of the MFIs under her survey was found to be centralized since most decisions were made at the head office. Employees in the survey were only involved in decision making through meetings with the management and through suggestion boxes. This apparent lack of open internal communication hampers growth. Management was found to be authority-based and this affected MFIs growth negatively.

Kahaso (2012) explores key success factors for microfinance institutions in the Kenyan coastal town of Mombasa and highlights availability of resources, innovative capacity, superior products and marketing capacity to be crucial for MFI success and growth. It is therefore the role of management of these MFIs to align resources to achieve overall growth whilst building on these internal strengths. Macharia (2011) explores the various success factors for MFIs in Kenya and concludes that these institutions implemented best practices as requisite measures to enhance their competitiveness and ensure overall sustainability in the long run. She however notes that there exist shortcomings when it comes to investing in staff training and development and customer education and sensitization. These are important facets in any organization looking for success since quality management was the driving force of other initiatives in the organization. The study concluded that MFIs should adopt formalization and transparency in financial reporting, product-delivery innovations, operational efficiency, sound financial management, financial market reforms, good governance and creation of value network to achieve sustainability in the market.

MFIs have a goal of extending financial services to customers who can’t access financial services with ease from commercial banks and such activities are described as outreach. Although there has been a concerted effort by various stakeholders in Kenya, outreach is still low despite the huge demand. The Central bank of Kenya annual report of 2012 indicated that only 2.4 % of the population had access to micro credit with only 0.5M loan accounts (CBK, 2012). This has led to failures and huge losses of MFIs despite securing the necessary infrastructure and the much needed capital and this is largely attributed to low levels of education, motivation and apparent lack of skills among the workforce (CBK, 2012). The low outreach coupled with a high defection rate is attributed to managerial incompetence to employ credit policies effectively in meeting customer needs. There lacks adequate study on the effect of outreach on the growth of microfinance institutions in Kenya and particularly Nakuru County. This study therefore strives to answer the question: what is the effect of outreach on the growth of micro finance institutions in Nakuru County?

1.3. Objective of the Study

The objective of the study was to establish the effect of outreach on the growth of microfinance institutions.

1.4 Specific Objective

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1.5 Value of the Study

Micro finance plays a vital role in the socio-economic development of the country. The study will be important to a number of stakeholders as outlined in the paragraphs below and this greatly shows why micro finance is deemed necessary for societal emancipation. The owners of microenterprises or small businesses will be able to know their contributions towards the success and growth of the microfinance institutions which are important to their operations since they provide financial services which may not be offered by major commercial banks. Eventually, they will take up their ultimate role in supporting the performance of these institutions.

By focusing on achieving institutional financial growth, regulators and practitioners of microfinance in Kenya and the entire financial system, the study will contribute towards domestic institution building for financial capacity widening and deepening in locally constituted organizations. The information so provided will prove invaluable as the policy makers look for ways of improving the financial system in Kenya. The study will also provide a source of reference for future studies on microfinance institutions and other related studies. It will also act as a source of literature for academics in the field of entrepreneurship.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter presents a review of literature that is related to the study. The chapter further delves into the various theories present about the growth of micro finance institutions, viewed from the standpoint of a firm.

2.2 Theoretical framework

This part explores the various theories put forward by recent econometric work on growth of firms. Recent resource based theories of the firm have more say about corporate growth but the core competencies or internal assets/skills which they are based on are also difficult to observe. The four theories of the growth of the firm are explored below.

2.2.1 Stage Theories of Growth

There have been numerous attempts over the years to identify life cycles of firms, model their evolution or even pick out identifiable stages through which they grow. Greiner (1972) argued that firms evolve through five phases, each characterized by a period of relatively stable growth. These phases, which he identified with a label which indicates the nature of the management problem characteristic of each: “creativity, “direction”, “delegation”, “coordination” and “collaboration” are separated by four crises of leadership, “autonomy”, “control” and “red tape”. More recently, Garnsey (1998) has developed a model of corporate growth which traces out a set of phases which correspond to the development and deployment of new internal resources in young firms. But Mueller (1972) argued that what a firm does, that is, its propensity to maximize profits or sacrifice profits for growth varies with age (and other factors like investment opportunities). A strictly profit maximizing firm is likely to enjoy only a finite burst of growth associated with each innovation. However, if the innovation fuels enough growth to weaken the power of shareholders, then managers will gradually acquire some room to exercise discretion. Since they are liable to be more interested in the size or growth of the firm than its profits, they will take advantage of this discretion to reinvest too much of the proceeds from the innovation into this or other investment opportunities. Consequently, "too much" growth is likely to be associated with each innovation, and it is likely to go on for "too long" (Geroski, 1998).

Entrepreneurial firms eventually outgrow their founders and become bureaucratic institutions, all firms mature and may decline and disappear, and they are often a useful aid to conceptualization. However, even if all firms progress through all five of Greiner's phases, they are likely to do so at very different rates and will probably enjoy different growth rates in each phase (Geroski, 1998). Similarly, although it is not hard to believe that goals of a firm change systematically over time, it is hard to know exactly how one might see this in the data on annual growth rates. The point here is that this theory posits that there are secular or long run deterministic trends in the pattern of growth of firms. Geroski (1998) notes that growth rates display stochastic trends, that is, firm size evolves in an erratic and unpredictable manner over time. Current period shocks which propel a random walk are permanent, and as a consequence, their effect in the long run is almost the same as it is in the short run.

The firm’s human resource level of competence also has a major role to play so as to enhance outreach or market share (Gibson, 2012).

2.2.2 Models of Organizational Capabilities

This theory by Penrose posits that firms can be viewed as bundles of resources bound together by a set of administrative skills or capabilities which are used to deploy them as effectively as possible. Nelson (1991) points out that successful firm can be understood in terms of hierarchy of practiced organizational routines, which define lower order organizational skills and how these are coordinated, and higher order decision procedures for choosing what is to be done at lower levels. These routines are part of a firm’s resource base and they define what the organization is capable of doing or what its competencies are. These skills are viewed as bundles of skills and one of the more important repositories of tacit knowledge inside firms. Since knowledge is the foundation of organizational capabilities or competencies means two things: first, that these competencies are not assets (and do not, therefore appear on balance sheets and cannot be bought and sold) and second that they can only be learned or maintained through use (Geroski et al, 1997).

Penrose (1959) argues that there is an intimate and tacit knowledge of the firm's resources, capabilities, organizational structures, standard operating procedures, unique historical conditions, and personnel, including human capital asset specificity. The fact is that the management adopted by any firm plays an integral role in the growth of that particular firm. This is because decision making is subjective and allocation of the firm's resources determines the overall performance of the entity.

Managerial capability is the binding constraint that limits growth rate of the firm, the so called Penrose effect; for instance, limits on the absorption of modern technology. Each firm is likely to be born with some particular skill or knowledge base and then develop it idiosyncratically over time as it uses what it has inherited and what it has learned to develop new skills and an augmented knowledge base. This then means that each firm's development is likely to be path dependent. The basic premise of this work is that competitive advantage is based on the possession of a few key resources and routines, organizational capabilities or core competencies and despite the proliferation of labels, there is some measure of agreement on what this actually means (Goodwin, 1998). If competitive advantage is based on the possession of core competencies , then firms are likely to be heterogeneous (because competencies are unique) and realize different levels of performance over long periods of time.

Simply put, if the accumulation of competencies is really what powers growth, then the kinds of competencies which we need to identify are those which either have very transitory lives or have only very temporary effects on growth. This theory remains relevant to this study in that staff competence has a huge role to play if the particular MFI is to grow in terms of customer numbers (outreach) and ROA (Woller, 2001).

2.2.3 Models with Penrose Effects

The study of the growth of the firm by Penrose has two different types of propositions. One is a "resource push" theory of endogenously driven growth and the other is the famed "managerial limits to growth" hypothesis which is explored here. This proposition is premised on the argument that management is a team effort in which individuals deploy specialized, functional skills as well as highly team specific skills that enable them to collectively coordinate their many activities in a coherent manner, The knowledge which underlies these specific skills is likely to be tacit and can only be learned experientially or by direct instruction from existing managers (Geroski, 1998). Therefore as the firm expands it needs to recruit new managers and it must divert at least some existing managers from their current responsibilities to help manage the process of expanding the management team. Since diverting current managerial resources to training new managers carries an opportunity cost, the faster is the planned rate of growth of the firm, the higher are these costs of growth likely to be, that is adjustment costs are variable. Under these circumstances firms are likely to smooth out their responses to current growth opportunities, sacrificing current profits but saving some of the costs of growth which may otherwise incur to gain those profits.

Penrose further argues that firms had no determinant long run or optimum sizes but only a constraint on current period growth rates. In the long run, firm size is unpredictable notes Geroski (1998). Most adjustment costs associated with growth are incurred within a year which is rather implausible because it can take years to mould a successful management team. He explains that adjustment costs are not very large and the collective contribution of all lagged dependent variables to the overall explanation of the regressions is usually extremely modest, and this implies that managerial limits to growth do not appear to explain much of what we observe. A firm faced with variable adjustment costs of whatever type will have an incentive to begin adjusting to shocks which it expects to occur in the near future.

2.2.4 Models of Optimum Firm Size

Much of the theory of the firm has been expressed in terms of a steady state equilibrium configuration with scholars trying to do comparative static exercises. One of the best known arguments is that competition will drive firms to the bottom of their U-shaped average cost curves. And if firms have market power, then their optimum size may differ from its minimum cost position, and if economies of scope exist, such differences may be more noticeable and of course, firms will be diversified in this case (Geroski, 1998). Recent arguments have posited that the degree to which costs are sunk (either endogenous or exogenous) and the intensity of competition may also be determinants of firm size (and market structure). Internal organizational factors may be as important as market competition and technology in determining firm size (Woller, 2001). The ability of managers to control their firms may be limited by serial errors in communicating up and down a management hierarchy or by other transaction costs. These are problems which can be mitigated by restructuring the organizations, but the bottom line is that sooner or later firms will get too large to control.

2.3 Empirical Evidence

Woller (2000) review the financial viability of village banking, a common lending program for MFIs, using data for nine institutions. He looks at the relationship between the return on the institution's loan portfolio and various operational cost measurements. As with Christian et al it is difficult to make strong conclusions from the small sample but Woller finds three strong indicators of financial health- portfolio yield or return, the interest spread and number of active borrowers. The study found that many efficiency variables were uncorrelated with the return on the portfolio, that is, many institutional factors are less important. Of these three key indicators, only number of borrowers or outreach can effectively be managed by the institution. Thus, MFIs may better achieve sustainability by increasing the size of their operations.

Woller & Woodworth (2001) finds no relationship between institutional size and sustainability. Many institutional variables were not found to be significant but there was a positive relationship between financial self-sufficiency and depth of outreach. The study used data over a three year period from thirteen institutions operating village banking operations. The data set is robust, including many measures of institutional operations, but only 13 of the 148 institutions in the *Micro Banking Bulletin* could be reviewed and the regression results could not be measured using fixed effects procedures.

Kagwara (2006) notes that banks and MFIs under her study were involved in credit decisions and this helped the institutions stem credit risk. This then means that adequate skill among staff could greatly help the MFIs to grow. They were also involved in debt management right from origination to delinquent management.

Maina (2011) found out that economic factors could be contributing to growth of micro finance institutions in Nyeri District, Nyeri County in Kenya. She further notes that the MFIs reported low turnover and this was grossly below demand. This deficit in turnover was attributed to a low number of savers and a high number of defaulters. This directly holds that the MFIs' PAR was skyrocketing. He further observes that internal factors such as resistance to embrace change in ICT, lack of funds to finance modern technology, and an apparent lack of skills among the workforce impacted negatively on the growth of the MFIs. Maina also notes that most of MFIs do not carry out basic research thus denying them a chance to improve on their products and service delivery, get new markets, and learn customer pain points. The management was found to be centralized since most decisions were made at their head offices. Employees were only involved in decision making through meetings with the management and through suggestion boxes. Management was found to be authority-based and this affected MFIs growth negatively.

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2.4 Summary of Literature Review

The literature review expounded above generally indicates that managerial or staff competence influences customer growth through outreach. The research tries to fill gaps identified in the implementation of MFI strategies with due diligence by managers' competence while implementing and interpreting the various policies to staff. The gaps need strategic planning to facilitate the regular review of business plans and strategic direction for MFIs' alignment with other players in the market as they competence for customers. Since number of borrowers directly impacts on performance of MFIs, issues of marketing should be inculcated in the management decision making programs so as to enhance outreach.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

The chapter is an overall scheme or structure conceived to aid in answering the research question. It presents the methodology used to carry out the study. This includes the study design, target population, data collection tools to use and data collection technique and data analysis method in presentation.

3.2 Research Design

This study used a descriptive survey. The research problem was studied through the use of descriptive research design. A descriptive study is concerned with finding out the what, where and how of a phenomenon. Descriptive research design was chosen because it enables generalization of the findings to a larger population. The main focus of this study is quantitative. However some qualitative approach is used in order to gain a better understanding and possibly enable a better and more insightful interpretation of the results from the quantitative study.

3.3 Target Population

This study included all micro finance institutions in Nakuru County and therefore a census survey was carried out (Banking Supervisory Report, 2011). It was limited to the micro finance institutions that operate within Nakuru county at the time of the study (refer to appendix I).

3.4 Data Collection

The study used both primary and secondary data for analysis. The primary data was collected using semi-structured questionnaires. The questionnaires were administered on the unit heads of all the MFIs. Questionnaires gather qualitative data as they allow for additional questions if need be. The secondary data collected was for the period 2008 to 2012. The focus on the collection of written documentation will depend on sources such as annual reports issued by CBK, annual reports issued by each MFI and statistics issued by AMFI.

3.4.1 Data Validity and Reliability

A questionnaire protocol was developed. All the questions asked and the constructs of these questions were documented. The data was organized and presented in a logical and meaningful manner. The study was supported by semi structured questionnaires and archival records. The purpose of the use of multiple data collection instruments was to increase the construct validity of the research by ensuring the quality of data and identifying relevant insights. Moreover, it allowed the triangulation of data and methods to increase the internal and construct validity of this research.

3.5 Data Analysis

Data collected was purely qualitative and was analyzed by descriptive analysis. The descriptive statistical tools such as SPSS and Ms excel helped to describe the data and determine the extent used. The findings were presented using tables and charts. Data analysis used SPSS and Microsoft Excel percentages, tabulations, means and other central tendencies. Tables were used to summarize responses for further analysis and facilitate comparison. The aim of this study was to measure the effect of outreach on the growth of MFIs and therefore, a multiple regression analysis was conducted so as to determine the same. Independent and dependent variables of the study were determined by the results reached by previous studies and how far data was available for measurement purposes. The study narrowed down to one dependent variable, that is, increase in value of assets. This is because value for many financial institutions is measured in terms of asset base. As a consequence to test the relationship between outreach and growth of an MFI, this study adopted the estimated linear regression model below:

$Y=\alpha+\beta_1X_1+\beta_2X_2+ {}_{+}\varepsilon$

Where,

Y is the growth of the firm measured by increase in total assets,

α is the constant (initial size of the firm),

X_1 is the value of customer deposits,

X_2 is the number of customers,

ε is the error term.

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

This section will be a presentation of the analyzed data and the findings obtained from the primary data that was gathered from the set of respondents. In order to check for consistency and completeness, all questions that had been responded were cross-checked to ensure that they were done well. The data analysis was done by the use of Statistical Package for Social Sciences (SPSS) version 20.0. In this chapter, data for analysis, regression analysis, and interpretation were evaluated.

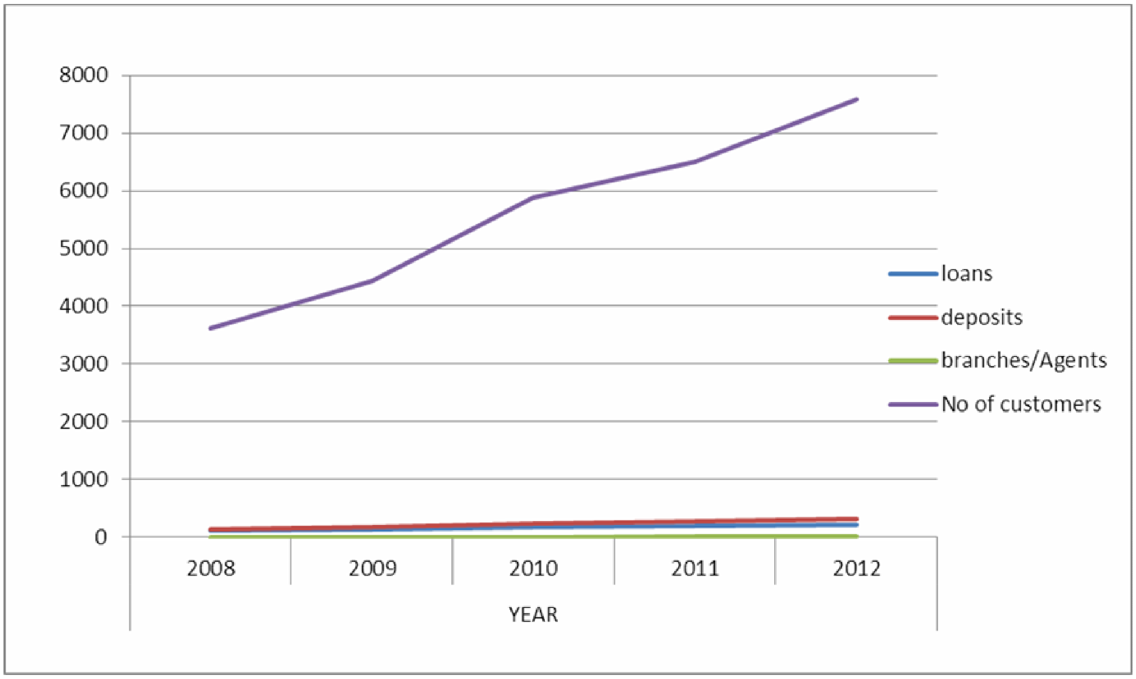
4.1.1 Response Rate

Utilization of the primary data collected through the questionnaires that were dropped and picked by the researcher was emphasized. The targets of the questionnaires were the business unit heads of the seven microfinance institutions in Nakuru County. The response rate of the questionnaires that were dispatched and completed by the respondents was 5 out of 7. There was an estimated 71% response rate (5 out of 7 respondents). This was however deemed an adequate response, which would be appropriate in the data analysis process.

4.2 Descriptive Statistics

From the figure 4.3 below it is clear that five MFIs under study experienced growth in assets (loans) with a corresponding increase in deposits. The number of customers grew exponentially while the number of branches and agents increased slowly. The rationale of this is that although an MFI may acquire a large customer base, deposits must first be mobilized before lending out in form of loans and other advances. The issue of expansion vide branches and agents is a measure that most MFIs consider least, probably because of the associated drain on capital and valuable deposits. It is also true that there was growth as the level of outreach increased.

Figure 4.1 Trend of loans, deposits, branches/agents and number of customers over the five year period of study, 2008-2012.



Research data, 2013

4.3 Regression Analysis

Data collected was analyzed through linear regression and results tabulated as below. While the researcher heavily relied on qualitative data provided by the respondents, it is clear that this data was only available in the MFI databases and were never published. The respondents noted that these figures were used for internal appraisal and performance tracking in their respective units. As such only the annual reports were made available and reflected the consolidated figures from all branches in the country.

Data was collected for the five-year period 2008-2012 in such parameters as loan portfolio, value of deposits held and customer base as at close of the years quoted. This was amalgamated to arrive at the final figures which were analyzed. Below are the regression results.

Summary Output

Regression Statistics								
Multiple R	0.991563759							
R Square	0.983198688							
Adjusted R Square	0.949596063							
Standard Error	7.860994017							
Observations	4							
ANOVA								
	df	*SS*	*MS*	*F*	*Significance F*			
Regression	2	3616.204773	1808.102387	29.25958	0.129619876			
Residual	1	61.79522694	61.79522694					
Total	3	3678						
	Coefficients	*Standard Error*	*t Stat*	*P-value*	*Lower 95%*	*Upper 95%*	*Lower 95.0%*	*Upper 95.0%*
Intercept	-55.4487699	39.81465928	-1.392672219	0.396444581	-561.3419821	450.4444423	-561.3419821	450.4444423
130	0.939279647	0.137735728	6.819433567	0.000926931	-0.810818712	2.689378007	-0.810818712	2.689378007
0.0034	3931.674505	1857.566447	2.11657274	0.002809883	-19670.94508	27534.29409	-19670.94508	27534.29409
	Growth=-55.4487699+0.939*deposits+3931.675*customers							
RESIDUAL OUTPUT								
Observation	*Predicted 115*		*Residuals*					
1	137.2116136		-2.211613638					
2	174.039687		5.9603130					

		34					
3	199.5531822	- 4.5531821 88					
4	217.1955172	0.8044827 91					

Growth in terms of increase in loans was taken to be the dependent variable while deposits and customer numbers were the dependent variables. From the regression results above, Adjusted R Square of 95% shows a clear association between X and Y. The R Square of 98.32% shows the amount of variance of Y explained by X in growth of MFIs. It further shows the amount of observed variance explained by the model. With a P-Value of 0.0013, the results reveal a statistically significant relationship between X and Y. The T-Values test the hypothesis that the coefficient is different from zero and this is evident from the results above. The value should be greater than 1.96 (at 0.05 confidence).

The T-Values also show the importance of a variable in the model. In this case, deposits are more important (with a T-value of 6.2) in the growth of MFIs and this explains why MFIs are so keen on liquidity and mobilizing for cheap deposits from customers. From the results above both deposits and customers are crucial for the growth of MFIs. The coefficients also show a strong positive correlation between X and Y. This means that when X goes up, Y also goes up. This has the implication that an increase in customers and deposits leads to an increase in assets. The intercept is negative in this case because without X there is no existence i. e without deposits and customers the MFI ceased to exist.

4.4 Summary of Findings and Interpretations

From the findings and subsequent analysis of the research data it was revealed that growth of microfinance institutions depends largely on availability of deposits and customer numbers. While the two seem correlated, it was found out that deposits are more important since these cheap liabilities could be sourced from a few customers and the same advanced out as loans. These loans could be advanced again to a few customers but in bigger packages. This partly explains why MFIs tend to place significant weight on deposits since their deficiency may push the entity to insolvency and in a worst case scenario force the MFI to close shop.

Moreover it was found out, statistically speaking, that the two variable in question actually affected growth of MFIs. While an increase in customer numbers led to an increase in deposits and net assets, this relationship did not show a straight line behavior. This means that a rapid increase in customer numbers does not necessarily depict a simultaneous growth in assets. This explains that customers have to build a relationship with their respective MFIs before getting loans. It is therefore recommended, based on the findings of this study that MFIs strive to enhance outreach through sourcing for more customers but with a greater emphasis on deposits which can quickly be converted to assets through sound lending.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Summary of Findings

This research study aimed at determining the effect of outreach on the growth of micro finance institutions in Nakuru County. The study found out that the majority of the microfinance institutions were less than ten years in operation in the county and were still struggling to increase outreach. Positive though was the fact that all of these MFIs were actually experiencing growth and the market was very receptive despite the competitive and risky nature of the business. Although the net assets grew slowly, there was nevertheless an upward trend, meaning that these institutions had very great prospects of growth in the days ahead.

It was also found out that the bulk of the MFI assets were loans and advances which were determined by the level of deposits or savings mobilized. To this end, the microfinance institutions insisted on funded savings accounts in their outreach campaigns. The more savings an MFI had, the higher the chances of advancing bigger and loans hence greater levels of growth. MFIs that had more savings experienced faster growth. There also exists a direct relationship between number of customers and MFI growth. This could be translated to increased savings on one part and also bigger loans advanced. This is also true of the other independent variable number of business outlets which increased levels of outreach. The use of agents in the MFI network greatly boosted its levels of outreach and hence faster growth.

There seems to be the assertion that levels of outreach determine the level of growth of any particular microfinance institution. Outreach here will be at the client level, savings/deposits outreach and loans outreach. An MFI that consistently increases the three will experience the greatest growth.

5.2 Conclusion

This study aimed at establishing the effect of outreach on the growth of micro finance institutions in Nakuru County. To this end, it established that, while outreach led to growth of microfinance institutions, the various aspects of outreach that is number of clients, value of deposits/savings and number of business units needed strategies to enhance before growth could be achieved. This is because the MFIs needed a vigorous deposit mobilization campaign as well as serious loan drives so as to leverage on these resources. The three went hand in hand. While expansion was deemed necessary, most MFIs opted for agents who were less risky and needed minimum capital. This explains the increasing trend in number of agents per MFI in recent years. It is therefore right to conclude that outreach has a significant and direct impact on MFI growth. The higher the level of outreach in the parameters discussed in this study, the higher the rate of growth.

5.3 Recommendations with Policy Implications

This study found out that the level of outreach has a great effect on the growth of microfinance institutions. This means that microfinance institutions ought to come up with policies that enhance increase in customer numbers and immense deposit mobilization as they explore expansion. This is because without clients and valuable deposits and savings the MFI ceased to exist. Managers in these institutions have a duty to formulate these policies. The various stakeholders, in liaison with the government and central bank need to oversee this and even devise ways of affording deposits and other sources of capital, say for example allowing MFIs to list at the Nairobi Securities Exchange, NSE. This will not only enhance financial inclusion but also further spur economic growth in line with the country's Vision 2030.

5.3.1 Recommendations for Further Research

This study found out that outreach plays a significant role in the growth of micro finance institutions. Since micro finance plays a crucial role in the socio-economic development of the Kenyan people, there is a dire need to expand research to the whole microfinance sector in Kenya. Further research could also be undertaken to determine the factors influencing the low levels of outreach among microfinance institutions in the country despite the huge potential in the country.

There is need to conduct more studies in the field of microfinance with a view to enhancing availability of other sources of liquidity for MFIs in Kenya as reliance on customer deposits may push these crucial entities to the periphery especially where a certain brand is favored over another due to the country's ethnic mix. The government and other stakeholders ought to find ways of offering cheaper deposits through the Central Bank to upcoming microfinance institutions. This will not only stabilize the sector but also enhance credit uptake among Kenyans.

5.4 Limitations of the Study

The study only comprised a small part of Kenya, Nakuru County and therefore the small sample did not necessarily depict the effect of outreach on the growth of microfinance institutions in other parts of the country. There is need to expand the scope of future studies that cover other parts of the country. The small sample size has not covered exhaustively about the effect of outreach on the growth of MFIs in other parts of the world.

Some of the respondents were not willing to give out the required data to the researcher for fear of being used by the competition. It therefore took abnormally long to get the questionnaires filled. Two of the respondent MFIs refused completely to release the data as per request. There was limited time for the research as the county is vast and traversing it needed more time and resources something that was never enough. This data was considered confidential and was available to the researcher after long hours of imploration and the good relations the researcher has developed with the major players in the county. Majority demanded that the finished project be availed to them.

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APPENDICES

APPENDIX I

List of MFIs in Nakuru County

1. Bimas Ltd

2. Changamka Kenya Ltd.

3. Faulu Kenya Ltd

4.Kenya Women Finance Trust, KWFT.

5.Micro-Kenya

6.Smallholder Irrigation Schemes Development Organization (SISDO)

7.SMEP

Source: Central Bank of Kenya (2011)

APPENDIX II

QUESTIONNAIRE

INSTRUCTIONS

Please respond to the following questions. The responses will be used for academic purposes only, and will be treated with utmost confidence.

1. Name of your institution (optional)…………………………………………………………

2. Number of years in operation…………………………………………………………………..

3. Kindly indicate the approximate value of deposits/savings held presently by your institution.

………………………………………………………………………………………………

4. What are some of the strategies you employ to mobilize savings/deposits in your institution?

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5. Kindly indicate the approximate value of all outstanding loans (your current loan portfolio.…………………………………………………………………………………

6. What are some of the initiatives and strategies your institution employs to grow your loan book?

……………………………………………………………………………………
……………………………………………………………………………………
……………………………………………………………………………………
……………………………………………………………………………………
………………………………

7. Kindly indicate number of business outlets/branches/ your institution has within Nakuru County…………………………………………………………

8. How many agents do you have in Nakuru County? ....

9. Would you prefer fully operational branches or agents? Please explain your answer

……………………………………………………………………………………
……………………………………………………………………………………
……………………………………………………………………………………
……………………………………………………………………………………

10. How many clients/customers do you currently have? ………………………..

11. Briefly explain the strategies you employ to grow customer numbers in your institution.

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……………………………………………………………………………………

……………………………………………………………………………………

12. Kindly fill the table below with details of the values of the variables held by your unit by close of the years highlighted.

Year	2008	2009	2010	2011	2012
Deposits					
Number of customers/clients					
Agents/business outlets/branches					
Loan book					

13. Which other aspects of outreach can be pursued most successfully to enhance growth of microfinance institutions? Kindly explain.

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Thanks for your time.

APPENDIX III: DATA

LOANS (Y) HELD 2008-2012

MFI	Y1	Y2	Y3	Y4	Y5	AVERAGE
KWFT	34,086,823	46,280,691	56,680,098	62,533,098	84,568,980	46,992,621
FAULU K. LTD	28,066,908	38,890,765	50,768,012	56,439,010	69,502,659	41,073,493
SMEP	25,000,501	34,689,084	37,087,317	44,623,308	48,061,083	30,310,426
BIMAS	22,342,920	31,710,929	32,702,840	38,632,891	43,019,050	25,679,261
SISDO	20,522,908	28,440,341	31,893,045	35,692,784	40,859,810	24,592,939
TOTAL	**130,020,060**	**180,011,810**	**209,131,312**	**237,921,091**	**286,011,582**	**168,648,739**

DEPOSITS (X_1) 2008-2012

MFI	Y1	Y2	Y3	Y4	Y5	AVERAGE
KWFT	29,240,843	34,567,349	51,857,670	55,456,348	63,840,893	56,829,938
FAULU K. LTD	24,876,834	28,395,627	46,564,983	49,659,034	55,870,986	48,733,471
SMEP	22,675,435	26,784,390	31,870,561	33,896,758	36,324,986	37,892,259
BIMAS	19,890,765	23,481,432	25,370,091	28,002,918	31,651,098	33,681,726
SISDO	18,326,123	21,871,930	24,356,891	27,985,840	30,423,910	31,481,778
TOTAL	**115,010,000**	**135,100,728**	**180,020,196**	**195,000,898**	**218,111,873**	**208,619,171**

CUSTOMERS (X_2) 2008-2012

MFI	**Y1**	**Y2**	**Y3**	**Y4**	**Y5**	**AVERAGE**
KWFT	1,023	1,607	1,949	2,112	2,656	1,869
FAULU K. LTD	856	1,436	1,808	1,847	2,413	1,672
SMEP	711	1,167	1,773	1,772	2,163	1,517
BIMAS	452	997	1,689	1,263	1,477	1,176
SISDO	360	801	998	1,114	1,313	917
TOTAL	**3,402**	**6,008**	**8,217**	**8,108**	**10,022**	**7,151**

Source, Research Data 2013