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RESEARCH ARTICLE

THE EFFECTS OF MICROFINANCE INSTITUTIONS ON THE SOCIO-ECONOMIC STANDARDS OF KILIFI COUNTY

Jackson Ilasemwa Gevera and Caroline Ayuma

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*Corresponding Author

Abstract

The study was carried out in Kilifi County in areas that include Mariakani, Kilifi, Mtwapa, Maweni, Kaloleni, and also Ganze, & Bamba which are considered among the top poorest areas in Kenya. The diversity in roles played by Micro Finance Institutions clearly reflects that the needs of individuals and enterprises living within such areas can change significantly over time. The main objective of the research was to determine the effect of Micro Finance Institutions on the socioeconomic standards of Kilifi County residents in relation to employment, social responsibilities and revenue generation. This study used descriptive data where research questionnaires were administered to a sampled size of 100 respondents whom the researcher intended to reach among the sampled target of 1000 beneficiaries and Micro Finance Institutions officials and used published and unpublished literature available in the public domain as secondary data from scholars and government planning dealing with Finance and promotion of rural developments in Kilifi County .

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1.0 Introduction

The World Bank defines Micro Finance Institutions as institutions that engage in relatively small financial transactions using various methodologies to serve low income households, micro enterprises, small scale farmers, and others who lack access to traditional banking services, CBS (1999). In another definition, the Microfinance Act, 2006, defines Micro Finance Institutions as a business receiving money by way of deposits and interest on deposits which is lent to others or used to finance the business; or providing loans or other facilities to micro or small enterprises and low income households; deposit taking and non-deposit taking (MFI Act, 2006).

In Kenya's Poverty Reduction Strategy Paper, the financial sector is expected to play a catalytic role in facilitating economic growth through Small and Medium Enterprises (Dondo and Ongila 2006). Access to formal credit by small-scale entrepreneurs has been quite poor particularly among the low-income category. This is largely as a result of the credit policies associated with loans provided by the formal financial sector (Ringeera, 2003). In 2005 there were approximately 3.8 million Kenyans depending on financial Non-Governmental Organizations, Cooperatives and Kenya Post Office Savings Bank for financial services (Dondo and Ongila, 2006).

The model shows an annual growth rate of 20% and a high recovery rate of loans of (98%). A still more interesting feature is the ingenious manner of advancing credit without any—collateral security. According to Mutua and Mirero (1985) in Kenya shortcomings in the provision of microfinance such as lack of a proper structure for loan disbursements and collection of repayments have reduced Micro Finance Institutions impact and their ability to meet the objectives of achieving poverty reduction through growth and development.

Microfinance, according to Otero (1999) is “the provision of financial services to low-income poor and very poor self-employed people”. These financial services according to Ledgerwood (1999) generally include savings and credit but can also include other financial services such as insurance and payment services. Schreiner and Colombet

(2001) defines microfinance as “the attempt to improve access to small deposits and small loans for poor households neglected by banks.”

In Kenya the microfinance started in 1980s and 1990s Kenya rural enterprise programme led the way in the provision of innovative financial services targeting the vulnerable poor. The microfinance sector has evolved for the last twenty years and has recorded notable gains. The sector has transformed itself from an insignificant player on the national and international psyche to its current level of innovation, sophistication and acceptability. To tap the potential, the industry has and extends the depth and breadth of outreach, the government of Kenya mainstreamed and transformed the sector by enacting microfinance act. The act brings on board a regulatory environment that hitherto has been missing in the past leading to collapse and defrauding o many Kenyans by these institutions.

The microfinance sector in Kenya consists of a large number of competing institutions which vary in formality, commercial orientation, professionalism, visibility, size and geographical coverage. The institutions further range from informal organizations such as Rotating savings and credit associations, financial service associations, savings and credit cooperative, Non-Governmental Organizations, to commercial banks (Dondo, 2003). According to Central Bank of Kenya report, Central Bank (2007) Micro Finance Institutions comprises of Microfinance banks, Commercial banks, Microfinance Non-Governmental organization, Companies limited by shares & guarantee, Building societies, Wholesale lending institutions and Joint Loan Board Schemes.

The microfinance Act 2006 and the microfinance regulation issued by Central Bank of Kenya thereunder sets out the legal regulatory and supervisory framework for the microfinance industry in Kenya. The microfinance act became operational with effect from 2nd May 2008. The principle objective of the microfinance act is to regulate the establishment of business and operations of microfinance institutions in Kenya through licensing and supervision. The act enables deposit taking microfinance institutions licensed by the central bank of Kenya to mobilize savings from the general public thus promoting competition, efficiency and access.

2.0 CREDIT AND THE POOR

Access to credit allows poor people to take advantage of economic opportunities. While increased earnings are by no means automatic, clients have overwhelmingly demonstrated that reliable sources of credit provide a fundamental basis for planning and expanding business activities. Poor people, with access to savings, credit, insurance, and other financial services, are more resilient and better able to cope with the everyday crises they face. Even the most rigorous econometric studies have proven that microfinance can smooth consumption levels and significantly reduce the need to sell assets to meet basic needs. With access to micro insurance, poor people can cope with sudden increased expenses associated with death, serious illness, and loss of assets.

Two countries that are known for success in microfinance are Indonesia and Bangladesh. Both contain several successful and much-studied Micro Finance Institutions, including Bank Rakyat Indonesia and the Grameen Bank of Bangladesh, the latter two transforming into private sector banks in the 1980s (Ramenyi 1997). Armendariz de Aghion and Morduch (2005), and Cull et al. (2006) found out that those participating in microfinance programs were able to improve their well-being-both at the individual and household level-much more than those who did not have access to financial services.

According to Yaron (1994), Chaves and Gonzalez-Vega (1996), Kaboski and Townsend (2005) a potential ingredient of Micro Finance Institutions success unexplored though, is the effect of macroeconomy. Guru and Shanmugen (1999), in their research on Malaysian banks found that efficiency in expense management was one of the most significant determinants of a commercial institution’s profitability. Bashir (2000) in his study found that Islamic banks profitability measure responded positively to the increase in capital and loan ratios. Their results also show the importance of customer and short term non-interest earning assets and overheads in promoting a bank’s profits.

Mjomba (2011) studied micro-finance in Kenya by specifically considering micro finance on financial empowerment of women in Kenya. This study though identified the impact of micro financing as empowering women positively, it majored on Kenya Women Finance Trust and was also bias to women only. Therefore it lacked evidence on other impacts of microfinances in Kenya. A similar study by Joy (2007) majored on the impact of microfinance on rural development with a setting of Makueni County. Although this study was a great milestone to

the studies on the field of impact of micro financing services, it narrowed down to poor households, income and poverty eradication.

In Rwanda, savings schemes have been considered as very crucial in assessment of the strength of a Micro Finance Institutions, Reinke (2001). This research study is in agreement with the role of saving to strengthen the base for the Micro Finance Institutions to grow as one aspect of diversifying and eventually their overall impact socioeconomically. In Malawi and Bukina Faso, the focus has been on the ability to repay loans not the Micro Finance Institutions whole strength, Reinke (2001)

Grants can be used to help overcome the social isolation, lack of productive skills, and low self-confidence of the extreme poor, and to prepare them for eventual use of microcredit. Small grants and other financial entitlements can work well as first steps to "graduate" the poor from vulnerability to economic self-sufficiency. A successful example is the Income Generation for Vulnerable Groups Development program in Bangladesh. This program has graduated more than 660,000 destitute women through free food, training, health care, and savings to mainstream microcredit program.

Community-level investments in commercial or productive infrastructure and also facilitate business activity. Employment programs prepare the poor for self-employment. Food-for-work programs and public works projects fit this model. In many cases, these programs may be out of reach for cash-strapped local governments but within the purview of donors.

Legal and institutional reforms can create incentives for microfinance by improving the operating environment for both microfinance providers and their clients. For example, streamlining micro-enterprise registration, abolishing caps on interest rates, loosening regulations governing non-mortgage collateral, strengthening the judicial system, and reducing the cost and time of property and asset registration can foster a supportive climate for microfinance

3.0 STRATEGIC PLACEMENT

The provision of finance by the Micro Finance Institutions ensures a way through which small scale entrepreneurs access capital and start businesses that can ultimately lift them out of poverty. Access to finance is vital in order to start or expand a business and economic scholars like Muhammad Yunus, Joseph Blatchford, and Friedrich Wilhelm Raiffeisen come up with the idea of village banks that offered the solution to provision of finance (Yunus, 2007). These village banks are located near the targeted individuals and residents so that they can easily access credit facilities for capital needs that can enhance investment opportunities and the performance of Small and Medium Enterprises' (Gongera, 2011). Internal equity such as retained earnings is a more convenient source of corporate financing for Micro Finance Institutions.

The wider geographical coverage of Kilifcounty extends to the rural areas some of the institutions operating in the area covered are Yehu, Faulu Kenya, Milango Financial Services and Friends for Life. Banks such as Co-operative and Equity Bank are also targeting the lower end market in areas like Mariakani, Kaloleni and Mtwapa. However with the current unemployment rates and high costs of living due to inflation, retained earnings may simply remain a dream since most of the financial services offered are beyond reach to a larger percentage of the resident and cannot afford to buy basic needs/physiological needs such as food, shelter and clothing as advocated by Maslow as illustrated in his book (Enos, 1992).

The banking sector in Kenya is fairly vibrant by the standards of developing third world countries, however the sector is 90% emphatically dominated by the formal commercial banks. These banks owing to their restrictive credit policy have largely catered for the big business only. This has meant that the small micro and medium enterprises have not been able to access credit as they cannot meet the bank's stringent credit conditions. To address the large gap in finance requirements for the small and medium enterprises, efforts have been made by assisting the micro finance institutions to move closer to the users and cater for their financial services requirements. Micro Finance Institutions cut across all sectors of the economy and have provided employment opportunities, reduce poverty and are bleeding ground for medium and large industries which have been to Kenya's economic development and ultimate industrialization by 2020.

In Kenya the Micro Finance Institutions driven by government, private sector and Non-Governmental Organization have embarked on a support by addressing the major constraints inhibiting their goals in addressing socioeconomic needs: Lack of collateral and inappropriate legal and regulatory framework that does not recognize innovative lending policy to the poor coupled with limited access to credit and financial services. Secondly there is no structural institutional mechanism to facilitate flow of financial resources from banks to Micro Finance Institutions, and then to the end users hence increasing cost of credit. This has led to a high number of Micro Finance Institutions branching out and concentrating their services to the rural areas, further more they have tailored services for local residents.

Most studies conducted on Micro Finance Institutions, for instance Naituli (2003) agree on the crucial small and medium enterprises of training and management to the successful performance of enterprises. This has seen a large number of Micro Finance Institutions embarking on frequent trainings and seminars aimed at disseminating more information to the locals on key socioeconomic issues. Some of the key factors affecting the performance of businesses are also addressed and can be divided into management competence and environmental factors. Management competence encompasses functional knowledge, management skills and managerial behavior.

Thus, competencies such as marketing, financial control, training and networking among others, are management functions, although in many studies, the success of the informal sector hinges on the managerial skills of the entrepreneurs who are attracted to the sector due to the relative low investment and service costs required.

3.1 EMPLOYMENT OPPORTUNITIES

It is now recognized that Micro Finance Institutions make a significant contribution to the socio-economic and political infrastructure of developed and developing countries as well as the nations in transition from command to market economies (Matlay and Westhead, 2005).

Furthermore, a healthy and growing Micro Finance Institutions sector is perceived to be crucial for sustainable competitive advantage and economic development at local, regional and national levels (Porter, 2006). In a study covering four Southern African countries: Botswana, Malawi, Swaziland and Zimbabwe, access to formal credit helps firms to survive only in Malawi (McPherson, 1995). In Swaziland and Botswana, the firms that borrowed from informal sources had higher chances of closing down than firms that had never borrowed from any source. In Indonesia, when the financial sector was liberalized, many inefficient firms that had been favored by government and getting credit at low interest rates simply collapsed and hence rendering a big (Harris et al. 1994).

3.2 GOVERNMENT INVOLVEMENT

Maix-Altes (2009) contends that microfinance institutions are unmistakable in their quest to spur on growth in entrepreneurship investment with initiation of advisory services for the entrepreneurs to continue seeking and wisely using their services. Between the 1950s and 1970s, governments, non-government organizations, and donors focused on providing agricultural credit to small and marginal farmers, in hopes of raising productivity and incomes offered investment advices. The credibility of the Micro Finance Institutions' can be determined by their sales volumes, profits realized and their expansion. Achievement of these factors depicts a favorable performance. In advancing the loans to Micro Finance Institution's, the micro finance institutions require securities for the business like title deed, Business registration certificates, certificate of life insurance policy etc. These among other key documents and policies are put in place by the governing authorities in place; sometimes these policies act as a detriment to the performance of Micro Finance Institutions and more so limit them in operation.

According to Yollin (2007), ACCION today is one of the premier microfinance organizations in the world with a network of lending partners that spans Latin America, Africa, and the United States. In 1972, SEWA Bank in India was formed by women as the initials stand for Self Employed Women Association and was registered as a trade union in Gujarat. The aim of this organization was to strengthen its members bargaining power to improve income of its members, create employment, and access social security.

Governments put in place different regulatory authorities such as Microcredit regulatory Authority in Bangladesh, the microfinance Act of 200 and SASRA in Kenya which operate as semi-autonomous government agencies to promote and foster sustainable development, monitor and report over the functions of Micro Finance Institutions and prevent and hazardous effect they may cause to the Kenyans.

The micro-finance organizations have thus become viable financial options to many small scale clients who seek small loans, employment as well as advices on how to wisely utilize the loans borrowed. From past Micro Finance Institutions interaction with small scale businesses, advisory services have immense influence on the entrepreneurs because they are advised on which actions would be drastic or beneficial to their businesses thus enable sustainable entrepreneurial growth.

3.3 IMPACT OF MICRO FINANCE INSTITUTIONS

The impact of Micro Finance Institutions on socioeconomic standards differs depending on their current stage of growth and development, location and capacity. However, it is agreed that most Micro Finance Institutions heavily depend upon external funding, bank loans and generally experience a 'financing gap,' even in developed countries. This financing gap, often defined as the difference between the demand for funds by Micro Finance Institutions and the supply of funds, occurs because of various reasons. Some fundamental reasons behind Micro Finance Institutions' lack of access to funds can be found in their peculiar characteristics and because of market imperfections on the supply side. This finally has a significant impact on the socioeconomic impact they have on the environment with which they operate, in Kenya, the Micro Finance Institutions act as one of the major booster of the economy and according to economic survey (2006); SMES have over 20% of the Kenyan population employed in the country. However despite the major role of Micro Finance Institutions in the Kenyan economy few studies have been done to establish the effects of microfinance on the specific effect of Micro Finance Institutions on the socio economic standards. Therefore, this research is intends to explore some of the specific indicators that contribute to socioeconomic development and attribute this to the role played by the Micro Finance Institutions sector.

4.0 FINDINGS

The targeted group show a large group of the beneficiaries were aged 31-35 and this shows a wealth of experience in saving for those who started early in life, this is main attributed to the fact that most of people then to have commitment at this age hence the need to seek for a livelihood. The least in term of aged were those with above 41 years which could be attributed to the fact that most of this aged are already established in life if they had started with Micro Finance Institutions early in life.

On the level of education for the beneficiaries shows that most of them are O-level according to 75% of the total responses. University graduates and post-graduate were minimum with 10% and 5 % respectively. There were a small group of 5% with No education at all but have benefit from Micro Finance Institutions schemes

The research shows that majority were Christian accounting of 45% followed by Muslims with 35%. There was a minority group of Hinduism and other with 5% and 10 % respectively. Majority of the interviewed people were married accounting of 63% followed by single with 26%. There was a minority group of Divorced/widow with 11%. The size of households show that majority of the beneficiaries have between 6 to 10 members of the family which accounts for 50% of all the total beneficiaries interviewed during this exercise. Those with 4 but below 6 members account for 30% from the total figures of responses, It shows that majority of the households have a bigger family responsibilities. There was a minority group of above 11 members in the family with 10% and those with less than 3 accounting for 5%. The main occupation of the beneficiaries' were business person accounting of 45% followed by self-employed with 35%. Micro Finance Institutions is most utilized by business people in kilifi country.

The level of income shows a range of 0-10,000 which accounts for 50% of the total people interviewed, it was followed by those within the range of 20,000 but less than 40,000 accounting of 35%. There was a minority group with above 40,000 accounting for 10% of the total number of responses. The monthly expense of the beneficiaries shows that majority spend below ksh 5000 per month accounting of 75% and a minority group spending above Ksh 5000 accounting for less than 10% of the total people interviewed in this exercise. On contribute monthly to the Micro Finance Institutions accounting to (55%), weekly (35%) and those contributing daily account for 5% only.

The research shows that majority of have been with Micro Finance Institutions for over one year, the reason for joining show intention to borrow for personal development. There was a wide variety on the usage of proceeds, business expansion, starting a business, building their family houses, poultry farming and few on purchase of land. Activities were helpful to the local residents with majority affirmative to it and being customizing their services to

suit the locals, the responses shows an affirmative towards agreement, being the greatest contributor to local development. On strategic placement majority of the people are living between 5 -10 Km away.

The average loan received shows that most of the people takes between 50,001 and 100,000 common small scale business. This is confirm by (40%) attributed to small business people going for deposit and withdrawal. Most have plans before taking loans. Most provide training on finance Management before advancing of money.

There were beneficiaries on employment opportunities arising as a resulted of Micro Finance Institutions presences (55%), Access to education (40%) which agrees to it. Government support is strongly felt in the sector by the beneficiaries, it shows the Government encouragement on expansion to the interior part of the country.

5.0 CONCLUSION

The conclusion of the research shows that there are more women than men in the usage of Micro Finance Institution or facilities in Kilifi, with female at 63% and male at 37%. The age bracket shows that those with aged between 31 to 35 are the majority in the borrowing of funds. And most of the members have O-level education. The religion shows that most of the members are Christian. 63% are married and 26% are singles, household members are between 6 and 10 in each family unity, main occupations are business and self-employed people. Average income level of around 10,000, few of them are ranging on between 20,000 and 40,000. It shows that most of them are falling under low income earners. On the monthly shows that a large numbers are spending less than kshs 5,000 per month. All the members have an account. Almost all of them belong to a group within the business or community activities and have been with Micro Finance Institutions for more than a year. The reason for joining shows the purpose of borrowing for personal development and others to assist them to save or when in problems. Some of the projects started using proceeds are business, poultry, houses and land development

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