

## **INFLUENCE OF MICROFINANCE SERVICES ON THE PERFORMANCE OF MICROFINANCE INSTITUTIONS IN SIAYA COUNTY, KENYA**

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**Abstract:** *Globally the groups seeking microfinance services are increasing from time to time but it is unclear on the extent to which these microfinance services can be linked to the financial performance of the microfinance institutions. The study focused on the influence of microcredit services, saving services, microcredit training services and capacity building packages on the financial performance of microfinance institutions in Siaya County, Kenya. The study was guided by the theory of economies of scale, credit market theory and the institutional theory. The study used descriptive survey research design. The study unit of analysis was the microfinance institutions. The target population comprised of 36 managers from four microfinance institutions. The sample size was 36 respondents selected by census sampling technique. Descriptive statistics and inferential statistics were used to establish the relationship between the variables in this study. The findings revealed that savings services (SS) had a strong association with Microloans Services (MicLS) .928 correlation value; and .880 correlation value with Micro Insurance Loans Services (MicinSLS) and .892 correlation value with Capacity Building Services (CBS). The results further showed that microfinance services had a strong association with financial performance of microfinance institutions ( $R = 0.916^a$ ), further the microfinance services explained up to 83.8% of the variation in performance of microfinance institutions and was indicated by high R Square value ( $R = 0.838$ ); the model used in this study can therefore be relied on by its users up to 83.7% (adjusted  $R^2 = .837$ ) as this result is statistically significant ( $p = .000 < .05$ ). The study recommended that microfinance services should be maximized to improve financial performance of the microfinance institutions in Kenya.*

**Keywords:** *Capacity Building Packages, Microloans Services, Micro Insurance Loans, Microfinance Institutions*

### **1.1 Introduction**

Financial services as savings and credit but include insurance and payment services (Ledger wood, 1999). According to Galor and Zeira (2012) microfinance is the attempt to improve access to small deposits and small loans for poor households neglected by banks. Therefore, microfinance involves the provision of financial services such as savings, loans and insurance to poor people living in both urban and rural settings who are unable to obtain such services from the formal financial sector. There are different providers of microfinance services and some of them are; nongovernmental organizations (NGOs), savings and loan cooperatives, credit unions, governmental banks, commercial banks and non-bank financial institutions. The target groups for

Microfinance Financial Institutions (MFIs) are self-employed low income entrepreneurs (Ledgerwood, 1999). They are designed not only to support entrepreneurship and alleviate poverty but also in many cases to empower women, the youths and the entire community.

According to Paul (2004) empowerment theory represents an expansive view of individuals and collective behavior that includes active participation of individuals and groups in altering the socio-environmental context. This study will be based on the empowerment theory of microfinance which suggests that by enabling people to access microcredit, it is one of the ways of reducing global poverty and enhancing economic development. According to Bogan *et al.*, (2007) Millions of people in developing countries have been given access to formal financial services through microfinance programs. Nevertheless, millions of potential clients still remain unserved and the demand for financial services far exceeds the currently available supply. Given significant capital constraints, expansion of microfinance programs remains a formidable challenge facing the microfinance industry. The microfinance sector was essentially driven by non-profit organizations and official development agencies. Today these institutions, together with a few new entrants in the sector, have set up an increasing number of investment structures to fund MFIs (Goodman, 2005). The microfinance community has recognized the limitations of donor and government subsidies in reaching a significant scale and scope of operations.

Microfinance in Kenya consists of microfinance facilities and regulations in Kenya which has been developing since 1990s. Legislation was passed in the year 2006 with the microfinance Act which became active in the year 2008. Microfinance has grown in Kenya in the last two decades in response to lack of access to formal financial services for most of Kenya's poor people. Currently the number of known MFIs operating in Kenya are approximately close to 100 serving over four million clients with an outstanding loan portfolio of kshs 2.3 billion. The lack of financial power is a contributing factor to most of the societal problems. MFIs therefore targets very poor people who are considered risky but whose repayment rates turns to be positive as compared with the regular commercial banks (Zeller and Sharma,1998). The loans give people new opportunities by helping them to get and secure finances to improve their living standards. It also plays both economic and social roles by improving the living conditions of the people. (Radio Netherlands 2010).

Ledger wood (2002 cited by Khachatryan, 2013) define saving as putting aside a certain sum of money to be accessible in the future in exchange for a series of savings made now. The various savings products and the amount deposited in the accounts constitute the total deposit of any deposit taking institution. Performance is the measure of how well an organization is able to generate revenues using the available assets (Capon, Farly & Hoening, 1990).

The diversity in the target market of the licensed MFIs has gone a long way in the achievement of deeper financial institution not only in the microfinance industry. According to Central Bank of Kenya reports 2015, MFIs assets based of Kshs 60,465,000.00 and a total deposit of Kshs 40,589,000.00 with a total capital of Kshs 11,583,000.00. further there were 932000 active deposit account and 342,000 active loan accounts (AMFI, 2017). The microfinance Act applies to institutions that conduct deposit taking business which are licensed by CBK. The regulation states that the minimum capital requirement for a nationwide microfinance institution is Kshs 60,000,000 while that of a community based institution is Kshs. 20,000,000. The regulation requires MFIs to submit quarterly single borrowers limit and insider lending report, annual board evaluation and asset review report, capital to risk weighted asset report, liquidity asset report, prepare, submit and publish in a newspaper of nationwide circulation audited financial statement.

The concept of group lending is the main innovation of microfinance and claims to provide an answer to the shortcomings of imperfect credit markets, in particular to the challenge of overcoming information asymmetries which may lead to the distinct phenomena of adverse selection and moral hazard. In the case of adverse selection, the lender lacks information on the riskiness of its borrowers. Riskier borrowers are more likely to default than safer borrowers, and thus should be charged higher interest rates to compensate for the increased risk of default.

The Kenyan Microfinance sector consists of a large number of competing institutions which vary in formality, commercial orientation, professionalism, visibility, size, geographical coverage. These institutions range from informal organizations e.g. Rotating Savings and Credit Associations (ROSCAs), Financial Services Associations (FSAs), savings and credit Cooperative Societies (SACCOs), Microfinance NGOs, to commercial banks. (AMFI, 2012) Kenya's microfinance sector comprises of nearly 250 MFIs, with only 56 of these being registered with the Association of Microfinance Institutions an umbrella body. Forty-four of these deal in credit-only facilities (non-depository), whereas only six are licensed as deposit taking institutions. The remaining institutions are unregulated by the Central Bank and offer microfinance services in combination with other social services. According to AMFI (2012) for DTMs and credit only microfinance institutions the main source of funding is borrowings, which account for 54.2% of the balance sheet in Dec 2011. Compulsory deposits account for 22.5% of the structure; however, they are on a downward trend from 28.8% as of Dec 2009, as voluntary deposits (sight and term) increased their share from 0.33% in 2009 to 6.32% in 2011. The Kenyan microfinance sector displays positive growth, strategic developments, and appears to be driven by product innovation. Portfolio shows sustained growth rates throughout the period. Omimo (2005) puts emphasis on sound development of MFIs as vital ingredients for investment, employment and to spur the economic growth.

## **1.2 Statement of the Problem**

The performance of Microfinance institutions is of great concern to all stakeholders as their services have gained reputable acceptance from all sectors as a development tool (Boateng and Adjei, 2013) and is now part of the financial system in the world. The rampant collapse of Microfinance institutions in most countries is of great worry and this has attracted several national debates. Empirical evidence indicate the importance of having sustainable MFIs than having those that are unsustainable (Nyamsogoro, 2010; Gashayie and Singh, 2015). This view has attracted attention of many researchers, development practitioners, organizations and governments of developing nations to research into how to enhance performance of the Microfinance Sector. The operating environment for the Kenya's microfinance industry has become dynamic requiring new business strategies. Further the challenges in the banking industry which has seen the collapse of some financial institutions while others being bailed out by the Central Bank as the number of banks posting losses especially the small and medium size banks which account for approximately 57% of the total industry (KIPPRA, 2013). This saw increased interest rates on loans which was the only source of revenue to the banks' income portfolio followed by investments in government securities (Olumuyiwa, Oluwatosin, and Chukwuemeka, 2012).

Siaya County Annual Development plan 2017-2018 and report (2018) revealed that despite the presence of microfinance services; it is not clear whether it is the high interest rate offered by financial institutions together with negative attitude of citizens has made the uptake of loans and other services from the microfinance institutions to be generally low. Further, most empirical studies have focused on enterprises accessibility to both financial and non-financial services provided by microfinance institutions; but little research has been done on microfinance services and financial performance of these microfinance institutions.

### **1.3 Objectives of the Study**

The main objective of the study was to assess the influence of microfinance services on their financial performance a case of micro financial institutions in Siaya County, Kenya. The study was guided by the following objectives:

1. To determine the influence of microloans services on the financial performance of microfinance institutions in Siaya County, Kenya,
2. To establish the influence of saving services on the financial performance of microfinance institutions in Siaya County, Kenya,
3. To determine the influence of capacity building packages on the financial performance of microfinance institutions in Siaya County, Kenya.
4. To determine the influence of micro insurance loans services on the performance of microfinance institutions in Siaya County, Kenya.

### **2.1 Theoretical Framework**

A theoretical framework is a collection of interrelated ideas based on theories. It is reasoned set of prepositions which are derived from and supported by data or evidence. It attempts to clarify why things are the way they are on theories (Kombo and Tromo, 2006). The study was guided by the following theories: the theory of economies of scale, credit market theory and the institutional theory.

#### **2.1.1 The Theory of Economies of Scale**

The Theory of Economies of Scale is a theory which is of interest to the study. This theory has been accredited to the renowned Economist, Alfred Marshall who devoted several pages in his Book, Principles of Economics to the discussion on the Internal Economies of Scale (Marshall, 1910). Marshall postulated that there is positive relationship between scale of production and efficiency which ultimately translates to decreasing cost of production.

#### **2.1.2 Credit Market Theory**

The neoclassical credit market model suggests that the terms of credits clear the market. In this model, the interest rate is the only price mechanism that can clear the credit market given that the loan collateral remains constant. With a growing demand for credit and a given loan and advances supply by the banks, the interest rate can only rise if the credit market is clear, and the reverse is true. The higher the default risks of the borrower, the higher the interest premium so as to compensate against any possible losses. The increase in demand for credit brought about by low interest rates eventually may lead to depreciation of currency.

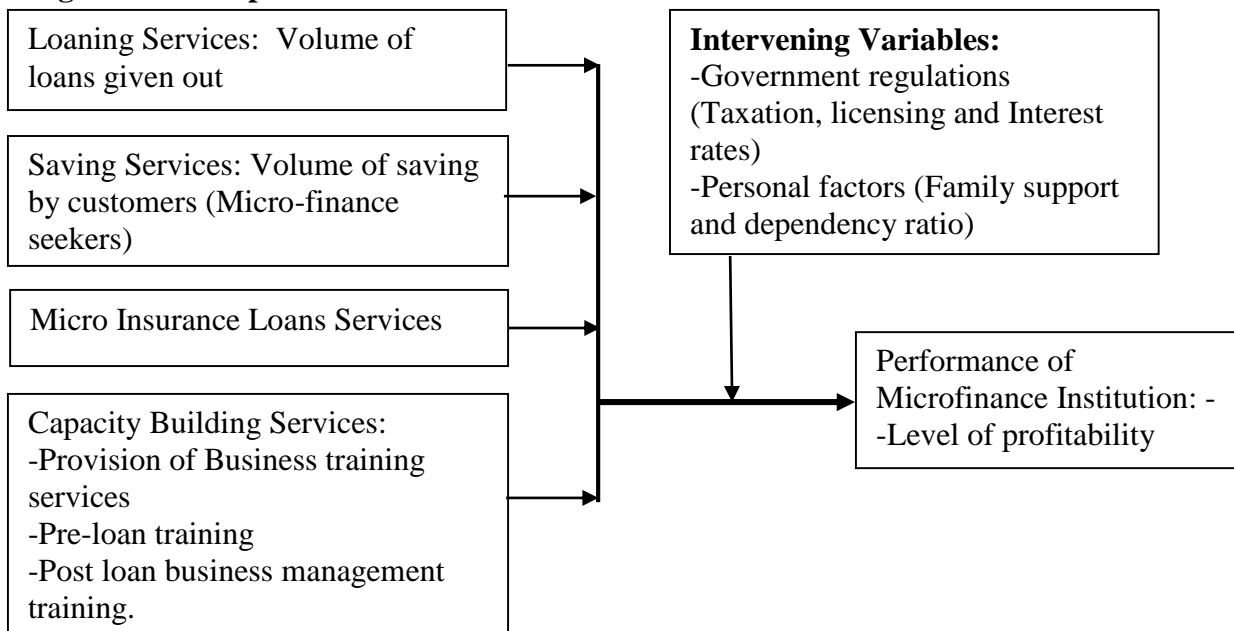
#### **2.1.3 The Institutional Theory**

The institutionalists' view of microfinance argues that MFI's should be able to cover its costs with its revenues. Institutionalists feel this self-sufficiency leads to long-term sustainability for MFIs, which will facilitate greater poverty alleviation in the long-term. The institutionalists' argument is consistent with Hollis and Sweet man (1998) who discuss historical cases in an attempt to identify institutional designs that facilitated success and sustainability in the 19th century loan funds in the UK, Germany and Italy. The authors conclude that the subsidized loan funds were more fragile and lost focus more quickly than those that obtained funds from depositors. The institutional theory criticizes the subsidization because it leads to high, unpaid rates and transaction cost, which has led to failure many microcredit programmes.

## 2.2 Conceptual Framework

Conceptual Framework is a set of broad ideas and principles taken from relevant field of enquiry and used to structure subsequent presentations. Conceptual framework involves forming ideas about relationships between variables in the study and showing these relationships graphically or diagrammatically (Mugenda & Mugenda, 2003).

**Figure 1: Conceptual Framework**



## 3.1 Research Methodology

This study adopted a descriptive survey research design. Mugenda and Mugenda (2003) define descriptive research design as a process of gathering data in order to test hypothesis or to answer a question concerning a current status of the elements or subject of the study. The study unit of analysis was the microfinance institutions operating in Siaya County and were registered by the Association of Microfinance Institutions in Kenya. The target population was 36 managers from the four microfinance institutions within Bondo sub-county Siaya County, Kenya. The target population of the study was constitute of the 4 MFIs Managers, 4 credit managers, 4 credit administrators and 24 credit officers making a total of 36 respondents from the microfinance institutions within Bondo Sub- County namely; KWFT, Faulu, Real People and SMEP. The study adopted census sampling technique. The study used both primary data and secondary data. The data collected from the field was analyzed using descriptive statistics and inferential statistics to establish the relationship between the variables in this study. The descriptive analysis involved the use of percentages, frequencies, means and standard deviations while inferential statistics involved the use of regression analysis and correlation analysis and the results were tested at 95% confidence level. The regression model below was used:

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \epsilon$$

Where; Y = financial performance (Profit Volume)

X<sub>1</sub> = Saving Service (Volume of Savings by Microfinance Seekers)

X<sub>2</sub> = Micro Loans Service (volume of Loans given out)

$X_3$  = Capacity building packages service (Market Share / Number of Clients)

$X_4$  = Micro insurance Loan services (Microcredit Default rate covered/ volume)

$\beta_0, \beta_1, \beta_2, \beta_3, \beta_4$  are regression coefficients

$\epsilon$  =error term

#### 4.1 Results on Business Sectors and Microfinance Services

The study established the business sectors of the economy seeking the microfinance services from the microfinance institutions. The information obtained from the field was categorized into groups as presented in table 4.1 below

**Table 4. 1 Business Sectors of the Respondents**

<b>Business Sector</b>	<b>Frequency</b>	<b>Percentage</b>
Retail and Wholesale Businesses	9	25%
Transport Businesses	5	13.8%
Jua Kali Businesses	15	41%
Hospitality Businesses	7	19.4 %
<b>Total</b>	<b>36</b>	<b>100%</b>

The results in table 4.1 indicate that Jua kali businesses at 41% response rate are the majority in seeking microfinance services from the microfinance institutions followed by those operating retail and wholesale business enterprises at 25% while those businesses in the hospitality sector form 19.4% of the response rate. The least in seeking the microfinance services are those in the transport sector at 13.8% response rate.

#### 4.2 Loans Volume Categorization and Frequency of Borrowing by Various Businesses

The study established the type and frequency of the loans categorization in terms of volume of loans borrowed and frequency of borrowing by the various businesses in the economy from the microfinance institutions. The information obtained from the field is presented as in table 4.2 below

**Table 4. 2 Loans Volume Categorization and Frequency of Borrowing**

<b>Business Sector</b>	<b>Percentage Frequency of Borrowing</b>
Under kshs 10,0000	48%
Between kshs 11,000 to kshs 50,000	65%
Between kshs 51,000 to kshs 100,000	72%
Between kshs 100,000 to kshs 500,000	22%
Over kshs 500,000	14%

The responses in table 4.2 indicate that in microfinance institutions the loans volume frequently sought by business enterprises are of category between kshs 51,000 to kshs 100, 000 as indicated by 72% response rate, the results further indicate that loans volume between kshs 11,000 to kshs 50,000 are also required as indicated by 65% response rate, the loans of over kshs 500,000 are least sought by business enterprises from microfinance institutions as indicated by 14% response rate.

#### 4.3 Business Performance Indicators and Rating of Microfinance Service Clients

The study established the business performance indicators used by the microfinance institutions to rate the business entrepreneur’s seeking microfinance services. These indicators of performance are used by banks to

determine the worthiness for these services. The information obtained from the field was rated on a five point likert scale where a weight of 5.0 = very great extent, 4.0 great extent, 3.0 moderate extent, 2.0 little extent and 1.0 no extent, the responses for this rating are presented as in table 4.3 below.

**Table 4.3 Business Performance Indicators and Rating of Microfinance Service Clients**

<b>Business Performance Indicators</b>	5	4	3	2	1	$\sum f_i w_i$	Std. Dev.
Growth in Sales Volume	19	8	4	5	0	4.139	14.160
Growth in Profit	23	8	3	1	1	4.416	19.000
Growth in Number of Employees	3	4	13	10	6	2.667	5.500
Accuracy of Books of Accounts	4	13	10	8	1	3.305	8.500
Loans Repayment History	17	10	5	4	0	4.111	12.833

Results in table 4.3 reveals that growth in profit is a performance indicator rated highest at 4.416 mean weight and with 19.00 standard deviation; the growth in sales volume is also rated high at 4.139 mean weight and standard deviation of 14.160; further the loans repayment history is rated at 4.111 mean with standard deviation of 12.833. This implies that profits, sales volume and loans repayment history contributes to great extent as indicators to qualify the worthiness of the microfinance service clients. The accuracy of the books of accounts indicator was rated at moderate extent at 3.305 mean weight and standard deviation of 8.500.

This study concurs with Raven and Le (2014) study on effects of business training programmes for women microcredit recipients in rural areas of Vietnam that business training can improve micro enterprise performance and has a number of other positive results, such as increasing motivation, success, and perceptions of entrepreneurs. Further Crepon et al. (2010) and Banerjee et al., (2010) study findings revealed a positive impact of microfinance services on business income and profits based on their studies, implying that MFIs also improved in their performance as default rate is minimized by the entrepreneurs seeking the microfinance services.

#### 4.4 Microfinance Services and Performance of Microfinance Institutions

The study sought to establish the extent to which microfinance services influence the Performance of the microfinance institutions. The respondents were asked to rate their opinions on a 5 point Likert scale from 5.0 most influential, 4.0 more influential, 3.0 moderately influential, 2.0 less influential and 1.0 not influential of the performance of the microfinance institutions; the responses were aggregated as mean weights and interpreted as functions of financial performance of microfinance institutions.

**Table 4.4 Microfinance Services and Performance of Microfinance Institutions.**

<b>Microfinance Services</b>	<b>Mean Weight(<math>\sum w f_i / \sum f_i</math>)</b>
Micro- loan Services	4.484
Savings Services	2.732
Capacity building services	4.409
Micro-insurance Loans	3.416

The results in table 4.4 reveal that micro-loan services mean weight of 4.484 and capacity building services mean weight of 4.409 are more influential on the performance of microfinance institutions while micro insurance loans are influential to moderate extent with a mean weight of 3.416 and savings services influence financial performance to a less extent at mean weight of 2.732.

The results concurs with Vingo (2012), on the performance of Microfinance Institutions. The study established that leverage in case of profit- making MFIs has significant effect on their sustainability. Further in agreement

with study by Kar (2011) that increasing leverage increases the profitability of MFIs; where debt including savings mobilization is increasingly becoming preferred source of funding for profit- making MFIs. The results concurs with the findings that Gross loan portfolio is positively related to Sustainability as well as profitability as increased in outstanding loan is likely to promote internal economies of scale which will enable MFIs to achieve higher self-sufficiency. The results concurred with Sabhatu (2011) study Management of Savings and Credit Cooperatives by identifying factors which affect the performance of Savings and Credit Cooperatives. Where lack of awareness and poor savings culture, weak organizational arrangement and governances, policy and regulatory environment, lack of differential products, weak institutional capacity and low capital base among others were considered to affect performance of financial institutions. These study findings are in agreement with study by Magali (2013) which revealed that deposits and age influenced sustainability of MFIs as further confirmed by Kipesha (2013). Availability of finance determines the capacity of an enterprise in a number of ways, especially in choice of technology, access to markets, and access to essential resources which in turn greatly influence the viability and success of a business, (Wole, 2009). Wole further states that securing capital for business start-up or business operation is one of the major obstacles every entrepreneur faces particularly those in the SMEs sector. This at the same time influences the creation of wealth by microfinance institutions.

#### 4.5 Regression Analysis Results

The correlation analysis of the variables is indicated as in table 4.6 below

**Table 4.5 Correlations Analysis**

Model	Profit	SS	CBS	MicLS	MicinSLS
Profit	1.000				
SS	.652	1.000			
CBS	.655	.892	1.000		
MicLS	.629	.928	.860	1.000	
MicinSLS	.753	.880	.852	.893	1.000
Sig. (1-tailed)		.000	.000	.000	.000

Where: SS-Savings Services, CBS-Capacity Building Services, MicLS - Microloans Services, MicinSLS-Micro Insurance Loans Services.

The correlation results reveal that savings services (SS) have strong association with Microloans Services (MicLS) .928 value; and .880 correlation value with Micro Insurance Loans Services (MicinSLS) and .892 correlation value with Capacity Building Services (CBS). These high correlation values indicate that the explanatory variables interact with each other as they influence financial performance of the microfinance institutions. The results in table 4.6 are coefficients values for explanatory variables relationship with the dependent variable.



**Table 4.6 Coefficients of the Microfinance Services and Financial Performance**

Model	Unstandardized Coefficients		Standardized Coefficients		Sig.	Collinearity Statistics	
	B	Std. Error	Beta	t		Tolerance	VIF
1 (Constant)	.317	.072		4.395	.000		
SS (X <sub>1</sub> )	.086	.021	.109	4.151	.000	.321	3.115
MicLS (X <sub>2</sub> )	.289	.037	.420	7.736	.000	.075	13.296
CBS (X <sub>3</sub> )	.064	.045	.081	1.418	.015	.067	14.876
MicinSLS (X <sub>4</sub> )	.031	.016	.047	1.918	.025	.377	2.652

a. Dependent Variable: Profit- Performance of Microfinance Institutions

Substituting the coefficients in the regression model:  $Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \epsilon$ ; The resulting model becomes  $Y = .317 + .086X_1 + .289X_2 + .064 X_3 + .031X_4$ ; this result indicate that a unit increase in the saving services causes 0.086 unit increase in financial performance. For the microloan services a unit increase causes 0.289 unit increase in financial performance of microfinance institutions while a unit increase in capacity building services causes 0.064 unit increase in financial performance and finally for Micro Insurance Loans Services unit increase it causes 0.031 unit increase in financial performance. Therefore microfinance institutions can maximize the use of microloan services to increase their financial performance.

**Table 4.7 Model Summary**

Model	R	R Square	Adjusted Square	R Change Statistics	
				F Change	Sig. F Change
1	.916 <sup>a</sup>	.838	.837	755.054	.000

- a. Predictors: (Constant), Savings Services, Capacity Building Services, Microloans Services, Micro Insurance Loans Services
- b. Dependent Variable: Profit- Performance of Microfinance Institutions

The information in table 4.7 show that microfinance services have a strong association with performance of microfinance institutions ( $R = 0.916^a$ ), further the microfinance services can explain up to 83.8% of the variation in performance of microfinance institutions and this is indicated by R Square ( $R = 0.838$ ); the model used in this study can be relied on by its users upto 83.7% ( $\text{adjusted } R^2 = .837$ ) and this result is statistically significant ( $p = .000 < .05$ ).

The results concur with past studies (Copestake, 2007; Armendariz and Szafarz, 2011; Mersland and Strom, 2010) where the unprecedented growth of the microfinance business was observed to contribute to an increased competition and commercialization, revealing the profit-seeking funding sources entering the business model of MFIs. Thus as the number of MFIs grew fast and tried to survive, the pressure to sell financial services led to saturation of markets and over indebtedness of clients. The competition and commercialization in this sector thus contributed to an increased focus on profit making; the trend of MFIs shifting their focus from social performance towards a stronger focus on profitability. This confirms the finding that microfinance services have a strong association with performance of microfinance institutions ( $R = 0.916^a$ ), further the microfinance services can explain up to 83.8% of the variation in performance of microfinance institutions.

The results further concurs with Czura (2010) who recognized that MFIs offer non-financial services such as business training, health education, and group meetings. The findings revealed positive effect to performance

of the microfinance institutions. The results differ with studies conducted by development economists (Banerjee et al., 2010; Crepon et al., 2011; Karlan & Zinman, 2011) their findings are inconclusive and have limited focus on how microfinance services influence entrepreneurial activity and in this context performance of microfinance institutions providing these services with the intent to gain thereafter.

## 5.1 Conclusion

From the findings on the influence of microloans services on the financial performance of microfinance institutions, the study concludes microloan services should be maximized to increase financial performance. It can be concluded that saving services influence the financial performance of microfinance institutions. Based on the findings on capacity building packages service the study concludes that capacity building packages service influence the financial performance of microfinance institutions. From the findings on micro insurance services, the study concludes that micro insurance services influence performance of financial performance of microfinance institutions in Kenya.

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