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Microfinancing and Poverty Alleviation in Arid Areas of Kitui County

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ABSTRACT: Poverty is a menace that has affected humanity across the globe for a long period of time and its eradication is important. A number of countries have established several institutions to act as vehicles for alleviating poverty. Poverty reduction remains a top priority on Kenya's development agenda and the country is committed to the realization of Millennium Development Goal and elimination of poverty by 2030. This study seeks to investigate the effect of microfinancing on poverty alleviation in arid areas of Kitui County. The specific objective of this study was to determine the influence of microfinancing on poverty alleviation in Kitui County. The research was informed by Microfinance Theory of Change. Mixed method research design was used with quantitative and qualitative data applied for analyses. Target population comprised of 5669 members of the six microfinance institutions in Kitui County. Stratified random sampling method was used to come up with 460 members who comprised the sample size. A structured questionnaire was developed and used for data collection. Inferential statistics were obtained from regression analysis which entailed normality test, multicollinearity test, model fitness, model specification and test of hypothesis done at 95% confidence level. These assisted in making the decision on whether to reject or accept null hypotheses. The study's null hypotheses was rejected. The conclusions were based on the study findings and recommendations derived. The study found out that microfinancing has a statistically significant influence on poverty alleviation. The study concluded that microfinancing influences alleviation of poverty that in cases where the amount received as loan is used for the intended purpose to uplift the living standards of members of the microfinance institutions. The study recommends that microfinance institutions should be encouraged to lower the lending interest rate by mobilizing savings in the informal sectors of the economy to improve access to finances. The study also recommends the microfinance institutions should train their members on proper financial planning and ensure that the money lend out is used for the intended purpose.

Keywords: *Microfinance Institutions, Poverty Alleviation and Microcredit*

I. Introduction

1.1 Background to the study

Microfinancing is the provision of finances to small scale enterprises and entrepreneurs who lack access to banking services due to high transaction. Samer (2015) refers to microfinancing as extending financial services to households with low income so that they can participate in trade as well as exploit innovative opportunities by starting new business, expand ongoing business or introducing new commodities in the market. Poverty alleviation has been a censorious issue over decades which has made it part of the development policy across the globe (Khan, Khan, Fahad, Ali, Khan & Luo, 2020). Over the years, Kenya has achieved limited success in the fight against poverty. The study done by Arp, Ardisa and Ardisa (2017) estimates that more than 2.8 billion of the 16 billion persons in the world live below US$2 a day.

In an effort to alleviate poverty, government agencies as well as non-governmental organizations have set up various departments to counter the menace. However, there have been extreme hurdles to Kenya's poverty reduction in the past. According to the Kenya National Bureau of Statistics (KIHBS), poverty levels are higher in rural areas at 40% than urban areas which stands at 29% while in arid areas which are sparingly inhabited poverty rates are close to 80%. As a result of climatic changes and economic depression the world economy is projected to grow only at between 1% and 2% which might affect poverty alleviation in the future (World Bank, 2020).

Rise of microfinance institutions further redefines indigenous socio-economic configurations which can be associated to poverty levels. These has aggravated societal disparities as a result of skewed distribution of resources in arid areas

(Dzanku, 2019). Despite the fact that some people in arid areas have benefited from microfinancing, those in immense poverty find it difficult to pool themselves out of den of poverty. The highest rate of poverty was recorded in the year 2017 through 2018 where more than half of the world population lived below $1 per day (Purnamawati &Yuniarta, 2020).Equally majority of Kenyans work in informal sectors making access to finances difficult because banks have high costs on making transactions. Additionally, the traditional mode of banking is perceived to belong to the elite making the poor to shun it.

A considerable size of the market in developed region assume that world's unbanked population has been reached with financial products (Quaye, 2014). Quaye (2014) further echoes that, microfinance institutions have been on the forefront in providing financial services to people in low sectors of the economy as well as Small and Medium scale enterprises in with an aim of economic liberalization. Microfinance institutions in Kenya are anchored on the Microfinance Act, 2006 which acts as the legitimate framework on which they are allowed to operate (CBK, 2016). As a result of this, Kenya's microfinance sector has grown significantly as per Economist Intelligence Unit (EW) which has rated it to be the best model in Africa (Otiende, 2015). However, the question which remains unresolved is on how it has contributed to poverty alleviation in arid areas. The 2006 baseline report and surveys of 2009 and 2013 indicates that Kenya has made progressive strides in enhancing financial inclusion (CBK, 2016). Many attributes financial inclusion in Kenya to have been triggered by mobile banking which has enabled a large population to access to financial services but still it is not clear whether this is the case in the arid areas.

1.2 Statement of the Problem

Various government policies have been developed to encourage microfinance. For instance, licensed MFIs have grown from one in 2009 to 13 in 2016 (CBK, KNBS & FSD-Kenya, 2019). Equally, informal microfinance institutions have risen from 32% in 2006 to 41% in 2016 (CBK, KNBS & FSD-Kenya, 2019). However, despite these effort, the levels of poverty are on the rise every day. In particular, 63.1% of the population in Kitui County live below the poverty line (Kenya National Bureau of statistics, 2020). In addition, the role of microfinance institutions is slowly changing to offering finances to low income earners and Small and Medium scale enterprises as a means to escape from poverty to tradeoff between profitability and sustainability. Microfinance institutions are facing numerous challenges as a result of coffers drain up and increased delinquency rates. Equally, most people in the arid areas are skeptical on whether microfinance institutions can be used to spearhead poverty alleviation campaign. Serving customers in Kenya is hindered by deficiency of clear governance and regulatory framework. In particular, those in arid areas are exposed to economic and social political shockwaves as well as lack of understanding of legal framework on which MFIs are anchored upon notwithstanding its structural instability. Microfinance institutions have not contributed much on poverty reduction due to diversity of business models which fall short of arid areas inclusion, lack of scalability to rural arid areas, disfranchised self-help clusters, huge transaction costs and challenges of know the customer amidst little resources for lending.

1.3 The purpose of the study.

The objective of these study was to determine the effects of microfinancing on poverty alleviation in arid areas of Kitui County

1.4 Hypothesis

This study strived to respond to the following hypothesis:

Ho_1: Microfinancing had no significant influence on poverty alleviation in arid areas of Kitui County

II. LITERATURE REVIEW

2.1 Theoretical Framework

2.1.1 The Microfinance Theory of Change

The proponents of microfinance theory of change were Datar, Epstein and Yuthas in the year 2008.The theory argued that an entrepreneur or a trader in need of finances can acquire money in form of loan from a microfinance institution. The borrower should be in a position to save an amount equal to the amount borrowed in order to grow the business. The business person should bear in mind that the borrowed amount will eventually generates adequate revenue to repay the loan together with the interest and still get enough surplus to cater for the basic needs so as raise his/her standard of living. For this to be effective it takes three steps. First, the business person acquires a debt inform of a loan from a microfinance institution. The method of acquiring this amount with begin by saving in order to get the minimum number of shares which can guarantee the sum to be borrowed. Second, the amount borrowed is put into an income generating venture. Finally, the person who has borrowed ensures that the funds are invested wisely so as to gain maximum profit and repay the loan. For microfinance institutions to assist in poverty alleviation, the theory holds that there should be clear Inputs channeled by the borrower in order to gain the confidence of the borrower inform of outputs and outcomes will be measured by ability to pay back the borrowed amount and keep the business afloat.

The theory is supported by Lensink and Sterken (2002), who argued that for any change to occur there should be an anticipated result. The theory of microfinance theory of change is anchored on the assumptions that although it being grounded on theoretical underpinning it must bring out a relationships which exist on a phenomenon based on best policies in order to produce the best results. According to Liverpool and Winter-Nelson(2010), the contribution of Microfinance on poverty alleviation is clear in situations where the amount to be lent is inadequate and needs to be controlled in order to be used optimally (Khandker, 2005).

Microfinance theory of change is based on the hypothesis that the surest way to poverty alleviation is to get small loans in order to achieve economic independence. The billions of cash provided to a huge number of Small-Scale and medium Enterprises as well as underprivileged entrepreneurs can raise the living standards household of immensely by upgrading dignity of women as well as improve the entrepreneurial skills of the children (Goldberg, 2005).

The theory is applicable to this study because it explains how microfinance institutions contributes to poverty alleviation. The theory supports that ones the funds have been borrowed from microfinance institutions and utilized well, the surplus can be used to support children's education, supports the family's basic needs and eventually provide sustainable self-employment income. This holistically would bridge the poverty gap in the communities where microfinance institutions exist.

2.2 Empirical Review

2.2.1 Microfinancing and poverty alleviation

Khandker (2014) carried a long panel survey using data which span for a period of over 20 years to establish whether diminishing returns to credit had an adverse effects on households' welfare. The survey established that households varied in each individual study. They noted that although some members saved their money in microfinance institutions it could guarantee that they could borrow because they need to save money and wait in order to borrow.

The study done by Quaye et al. (2014) affirmed that SMEs play a huge role in enhancing economic development of citizens. The study established that most entrepreneurs are denied access to finances as a result of the perceived risk by lenders and lack of collateral because few own assets such as land and motor vehicles where they can give title deeds and logbooks. However, the study supported that microfinance institutions enhance savings culture and uptake of credit though a portion of SMEs could be denied access to finance facilities.

Study carried by Okibo and Makanga (2014) in Kiambu County on contribution of microfinancing on poverty reduction applied descriptive survey design and stratified sampling technique to select the members of staff in the microfinance institutions. The study discovered established that if microfinancing could be positioned well in the economy it would be pathway to introduce credit facilities which could aid in poverty reduction.

Karlan (2016) did a study on the value of financial services in the lives of the poor. The study established that there was unsatisfactory information, behavioral biases, high transaction costs, inability to enforce laws on property rights and a lack of competition as key barriers to delivery of financial services to marginalized areas. The study further supported that most small businesses lacked insurance which made them fail to deliver on a large scale.

The study done by Christensson (2017) in Nigeria examined whether there was any correlation between existence of microfinance institutions and poverty reduction using the ordinary least square regression model. The study established that there was an undesirable correlation between the number of microfinance institutions and the degree of poverty.

Jakaand Shava (2018) examine the contribution of economic empowerment on rural women's livelihoods in Zimbabwe. The study applied a case study approach with an aid of interviews and focus groups. The study concluded that in order for women in rural areas to access competitive markets and innovative skills they need adequate funds to enhance economic liberation.

Kasali (2020) investigated the contributions of loans on microfinance institutions on mitigation of poverty in Southwest Nigeria. The study was a primary in nature and applied stratified sampling technique to collect cross-sectional data with an aid of a questionnaire. Although, the study established that the debt offered in terms of loans significantly aided on poverty alleviation the study pointed out that there was need for developing infrastructural facilities as well as financial aid to spur lending.

Poverty alleviation in Zimbabwe has been evaluated by use of simple regression (Mhlanga, 2020). The study intended to access the ability of small scale farmers to acquire financial services. The results disclosed that if small scale farmers were supported to acquire funds, poverty levels would decrease significantly. However, the study exposed that for small scale farmers to counter the poverty menace, they need to support microfinance institutions by opening saving accounts to enhance borrowing.

2.2.2 Summary and Research Gaps

A number of the studies done on microfinancing and poverty alleviation indicates that there is a constructive relationship between the two contrasts in different regions. Although, the core role of Microfinance institutions is to offer finances in form of debts in arid and rural areas to eradicate poverty, the naked reality is that as the institutions increase in number poverty levels raise day by day. The increase in microfinance institutions in Kenya and the ballooning poverty levels questions earlier results which established that there is a positive relationship between microfinancing and poverty alleviation. This raises questions than answers and merits extra exploration. Thus, this study intentions is to fill this gap by analyzing the connection between microfinancing and poverty alleviation in Kitui County, Kenya.

III. Research Methodology

This study used causal research design. The units of analysis were the 9690 members of the two major microfinance institutions (Microfinance institutions Report, 2021). Out of these, 7540 members were active borrowers, from which a sample of 380 respondents was obtained via slovin's formula.

Data for this study was collected by use of interview schedules. Data was then analyzed by use of Stata. The study performed diagnostic tests on the data. In addition, inferential statistics was used to determine the relationship between the predictors and the response variable.

The following logistic regression model was estimated. A value of 1 indicate that household's poverty level was likely to decrease, while a values of 0 indicate that a household's poverty level is likely to increase or remain constant.

Ln (odds ratio of P) = $ß_0 + ß_1L + ß_2U + ß_3S + ß_4H + ß_5A + u$

Where P is poverty alleviation, L is loan amount, U is loan usage, S is savings, H is household size, A value of physical assets owned.$\beta 0$ is the constant, $\beta$is are coefficients of independent variables where i is from 1 to 5, and μ is a stochastic error term measuring the effect of other variables that affect household poverty alleviation.

IV. Research Findings

4.1 Multicollinearity Test

Variable	VIF	1/VIF
Savings	1.02	0975613
Assets Value	1.02	0.978832
Loan Amount	1.02	0.984347
loan Usage	1.01	0.986340
Household size	1.01	0.987491

The study tested for multicollinearity using Variance Inflation Factor. From table above, the obtained mean VIF was 1.02 and the study concluded that multicollinearity was not a problem.

4.2 Breusch-Pagan test for heteroscedasticity

Ho: Constant variance
Variables: fitted values of P
chi2(1) = 8.79
Prob>chi2 = 0.0030

The study tested whether the residuals from the logistic estimator were normally distributed at a 5% level of significance to control for heteroscedasticity. The -value obtained was p=0.003, indicating that heteroscedasticity was not a problem in the data.

4.3 Logistic Regression

Logistic regression Number of obs = 380
LR chi2(5) = 75.61
Prob> chi2 = 0.0000
Log likelihood = -170.37738 Pseudo R2 = 0.8403

Logistic regression	**Number of obs = 380**		
	LR chi2(5) = 75.61		
Prob >chi2 = 0.0000			
Log likelihood = -170.37738	Pseudo R2 = 0.8403		
Variables	Odds Ratio	P>|z|	95% Confidence Interval
Loan Amount	1.000004	0.002	1.000002-1.000005
Asset Value	1.000001	0.106	.9999999-1.000002
Household Size	1.030477	0.564	0.9305743-1.141104
Loan Use	1.642924	0.024	.9714399-2.778554
.Savings	0.9999996	0.093	0.9999992-1.0

The results in table show that the amount of loan borrowed, use of loans as per the stated reason for borrowing and adherence to set credit guidelines were statistically significant. The coefficient of assets owned and the size of household were not statically significant in alleviating poverty.

4.4 Discussions of Research Findings

The coefficients of borrower's usage of the loan as per the loan agreement and the amount of loan borrowed were statistically significant at a 5 percent level of significance. This is because the purpose for loan borrowed was properly evaluated during lending and if used for the intended purpose, then the borrower was assured of maintaining the ability to pay as well as creation of wealth. The study established that the coefficients of asset ownership and household size were not statistically significant. This means that poverty alleviation implies acquisition of more assets which can only be achieved through investments in businesses.

V. Contributions of Research findings to the Society

The study will be of value to policy makers as they will gain knowledge regarding the contribution of microfinancing on poverty alleviation. This will therefore enable them come up with appropriate policies that will enable the government to adopt the relevant and effective poverty mitigation methods. The findings of this study will be helpful to the regulator of microfinances in formulation of better polices that are relevant in supporting poverty alleviation

5.1 Conclusion

The study found that microfinancing had a statistically significant effect on poverty alleviation. Other significant findings include how borrowers use the loan, and particularly in accordance with the loan purpose that was funded in the loan agreement, which has been found to statistically affect poverty alleviation. The study therefore concludes that borrowers should be encouraged to use the loan for the intended purpose. When a loan is used for the same reason as stated in the loan agreement, the borrower's capacity to pay is less likely to be harmed than when the loan is diverted to other uses.

VI. Recommendation

Microfinance institutions need to come up with a policy that provides a framework that prevents borrowers from diverting loans to uses other than those specified during borrowing. In addition, microfinance institutions need to strengthen the internal control system on review of loan applications by use of sophisticated technology to ensure that errors on risk management and controls are at minimal level. Microfinances need to be continuously trained on poverty alleviation mechanism so that they develop proper credit guidelines and policies which puts more emphasis on poverty alleviation.

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