

AN ANALYSIS OF MICROFINANCE INSTITUTIONS' PERSPECTIVES ON THE INTRICACY OF PROMOTING SMALL ENTERPRISES' FINANCIAL PERFORMANCE THROUGH MICROFINANCE: CASE OF HARARE, ZIMBABWE

Hosho Norbert¹, Gumbo Victor² and Pamu Emmanuel Mulenga³

¹Chinhoyi University of Technology, Department of Accounting Sciences and Finance

²University of Botswana, Department of Mathematics

³Government of Zambia, Ministry of Finance

ABSTRACT

The present study is firmly grounded on the widely established notion that the Small Enterprises (SEs) sector could be the probable key for unlocking economic emancipation and global competitiveness for developing countries. The study identifies microfinance institutions as a catalyst for the sustainability, growth and development of SEs. However, the process of financing SEs has never been easy for microfinance institutions (MFIs), according to global literature. The objective of the current study was to analyse both general and significant factors contributing to the intricacy associated with MFIs' efforts to promote small enterprise growth and development. The study uses financial performance as a proxy for SE growth and development. A 'mixed method' design was adopted for the study so as to combine the strengths of the qualitative and quantitative approaches while also offsetting the weaknesses of either approach. The research identified eleven factors influencing the promotion of SE financial performance by MFIs. The Stepwise Regression approach was applied to build the regression model. The results show that information access amongst SEs ranked as first followed by lack of collateral, limited training and diversion of loans by SE beneficiaries. Adequate liquidity in MFIs, clear plans amongst SEs and high competition in the market had the least impact. This implies that improving information access amongst SEs, addressing the collateral issue, providing adequate training to the SEs and addressing the diversion of loans among SEs may help to obtain significant positive impact on SE financial performance through MFI activities

Keywords: MFIs, SEs, Financial performance

INTRODUCTION

Small Enterprises (SEs) have been identified and touted in contemporary literature as possible catalysts for economic emancipation in developing countries; and Zimbabwe is no exception. It therefore follows that the financial wellbeing of small enterprises is of utmost significance in the Zimbabwean economy. Good financial performance depicts any company's wellbeing. A company that is financially sound has bright prospects for sustainable operations, growth and development. In most African economies, small enterprises constitute a significant proportion of the private sector.

In the Zimbabwean context, small and medium enterprises constitute the greater part of the private sector than the large companies, owing to both downsizing and closure of large

companies since the turn of the millennium. However, just like the large companies, small enterprises have never been without operational constraints. Key among them has been access to finance and related services. Small enterprises have had limited access to finance since time immemorial. This thus inhibits small enterprise growth and development. Mainstream financial institutions such as commercial banks have always offered inflexible credit terms with a repulsive effect on start-ups and small enterprises at large. Commercial banks typically insist on collateral, credit history, financial statement and banking history. Most of these requirements have since impacted negatively on small enterprises legibility for microcredit.

Thus over the years, small enterprises would end up relying on unpredictable sources of finance such as family capital and loans from friends. Researches on small enterprise financing, for example Yoshino and Taghizadeh-Hesary (2015), seem to conclude that small enterprises have a very high default risk hence their access to finance remains low. The SE financing constraint has seen a number of microfinance institutions coming up with microfinance services tailor made for small enterprises in Zimbabwe. But existing literature has it that globally; the MFIs' journey towards sustainable SEs has never been easy-going. Thus, although microfinance has been touted as a possible key for unlocking small enterprise financial performance, there remains some substantial intricacy in the process of financing SEs for enhanced financial performance, growth and ultimately development.

It is thus the objective of the current study to analyse factors contributing to the intricacy associated with MFIs' efforts to promote small enterprise growth and development. In achieving this objective, financial performance is taken as the proxy for enterprise growth and development.

LITERATURE REVIEW

Although there are numerous assertions with regards to MFIs such as their duty in assisting marginalised members of the populations, they are prone to some challenges in their operations. These challenges can be overcome in many cases but they are inevitable, therefore careful attention is needed. According to Moss, Neubaum and Meyskens (2015) information asymmetry poses risks to MFIs, which leads to adverse selection and moral hazard effects. In a world with fixed transaction costs and information asymmetries, small firms with demand for smaller loans face higher transaction costs and face higher risk premiums since they are typically more opaque and have less collateral to offer. Several authorities such as Beck and Demircuc-Kunt (2006) as well as Coad and Tamvada (2012) find that the higher financing impediments faced by SEs indeed translate into slower growth. Solli, Galindo, Rizzi, Rhyne, and van de Walle (2015) are of the view that once the client has the funds at his or her disposal, MFIs may have to struggle so as to ensure repayment of the money.

Shen and Reuer (2005) well articulate that adverse selection is a challenge posed by information asymmetry prior to a deal. Cowling, Liu and Zhang (2016) purport that the aforementioned scenario is prevalent in Small to Medium Enterprises (SMEs) lending whereby the borrower deliberately furnishes the financial institution with wrong information in concerted efforts to acquire a loan. Prior studies have exposed creative accounting and related fraudulent behaviours in Zimbabwe, for instance, Hosho, Matowanyika and Chinoda (2013). Thus, an entrepreneur may window dress his or her accounts so as to portray a healthier appearance of the

profitability position and the financial position. This may be accomplished by way of inflating sales figures, profit levels and asset values as well as hiding his or her other liabilities. Accordingly, the inflated figures place the loans officer in an adverse selection dilemma as they will be revealing a healthier financial position of the enterprise or project than the authentic state of affairs.

Tirole (2010) contends that the adverse selection difficulty pushes away noble ventures, thereby creating a 'market for lemons' in the lending books of MFIs. In a move taken for cautionary purposes, it has become common practice for MFIs to shift their focus from SE financial accounting information to the Know Your Customer (KYC) principle. With this approach, the much impeding collateral requirement is normally done away with. However, Araujo, Ferreira and Funchal (2017) maintain that collateral puts the lending institution in a better position, since there will be a way of recovering its amount in the event of default in repayment.

MFIs are further constrained by an unfavorable regulatory environment, deficient capabilities, lack of coordination and teamwork and also the absence of an explicit framework or set of standards for categorising the potential microfinance beneficiaries. As noted by Mohapatra and Kumar (2014), most MFIs lack the essential networks with mainstream financial establishments; they also lack enough skills, proficiency plus capital. In the view of Sloan (2013), the art of starting and operating an MFI entails beyond loan disbursement. The MFI rather needs to be sustainable and lucrative too. Authors such as Addae-Korankye (2014) underscore the need for engaging experienced and skilled people that are capable of assessing, approving or in some cases declining facilities, as well as offering advice to clients.

Basu (2006) asserts that most MFIs struggle with very high operating costs due to vast numbers of loan applications, which need to be processed, apt management and also maintenance. An additional challenge, which is considered cancerous by several authors, is that of loan defaults. Loan defaults negatively influence the feasibility of MFIs. According to Zottel, Zia and Khoury (2016), non-repayment of loans by borrowers discourages MFI employees and subsequently some other valuable potential borrowers end up being disadvantaged as they may fail to access funds. Another view, particularly in the Zimbabwean context, is that MFI lending rates remain prohibitive due to the high cost of money (Karedza and Sikwila, 2016). Thus, cash flow challenges obstruct the growth of MFIs.

DeNisi and Smith (2014) argue that management performance and skills are closely related with the firm's financial performance. The author maintains that better results can be achieved where the management team has the four traits of management, which are the leadership, technical, organizational and communication skills. Hosho, Muguti and Muzividzi (2015) seem to concur with Hudson (2006) as they propose a portfolio of measures to contribute towards an integrated model for sustainable compulsory entrepreneurial education across the Zimbabwean education system. If the measures are fully implemented, then the majority of start-ups and other SEs will have fully knowledgeable and capable management teams. Neubauer and Lank (2016) envisaged that besides extending microfinance to an enterprise as an ingredient for the enterprise's growth and development, one other imperative constituent is good corporate governance could assist in improving the performance of a firm as well as ensuring its survival in the long term. It is therefore imperative for SEs to ensure that corporate governance structures

are properly established.

After a thorough analysis of the literature, we conclude that the intricacy of promoting SEs through microfinance is three-fold. The contributing factors fundamentally fall into one of the three categories namely, MFI specific, SE specific and general factors.

RESEARCH METHODOLOGY

A Mixed Method design was adopted to combine the strengths of the qualitative and quantitative approaches while also offsetting the weaknesses of either approach. Such integration permitted a more complete and better utilization of data by triangulating data sources to obtain convergence across qualitative and quantitative methods (Hussein, 2015). Registered MFIs as at 31 December 2017 were considered as the population of the study. The sample size consisted of 64MFLs drawn from a population of 189MFIs. The sample size was calculated using the Krejcie-Morgan-sample-size-table designed by Krejcie and Morgan in 1970, at 95% confidence level, with a margin error of 0.1. A database file of the registered MFIs was collected from the Reserve Bank of Zimbabwe and the systematic random sampling method was applied to obtain sample participants. The database was sorted in ascending alphabetical order and the 3rd member was selected to obtain a total of 64 participant MFIs, obtained using the formula:

$$n^{th} \text{ term} = \frac{\text{Total Number of population}}{\text{Sample size}}$$

A questionnaire was developed and administered on the sample members to obtain primary data for analysis. Closed ended questions helped to obtain quantitative data while open-ended questions facilitated the collection of qualitative data. A total of 56 questionnaires were returned, out of the 64 administered, yielding an 88% response rate. Data cleansing was performed in order to bring order, structure and meaning to the mass of collected data (Gelman and Hill (2006). Therefore, data from the questionnaire was edited, ordered, coded, classified, tabulated and summarised. Editing was done to ensure the identification and elimination of errors that were made by respondents. It was also intended to enhance accuracy, consistency, completeness and uniformity of data collected to simplify coding and tabulation of the findings (Kothari, 2004). The dependent variable for this study is SE financial performance. This was measured in terms of liquidity (acid test ratio). The independent variables were broadly classified into: MFI factors, SE factors and General Factors. MFI factors comprised challenges within the MFIs; SE factors comprise challenges at the SEs while general factors were other factors within the industry. These variables are clearly shown in Table 1.

Table 1: Variable Identification for the Study

Variables	Interpretation
x_1	Diversion of loans by SEs beneficiaries
x_2	Adequate liquidity in MFIs
x_3	High competition in market

x_4	Clear plans among the SEs
x_5	Information access among the SEs
x_6	Lack of collateral among SEs
x_7	Limited training among the SEs
x_8	Fraud among SEs
x_9	Unregistered SEs
x_{10}	Strict terms and conditions
x_{11}	Ineffective leadership in the SEs

The Stepwise Regression was applied to build the regression model. The SPSS package was used and it added or removed the predictor variables using F-test or T-test from an initial set of eleven variables; and then eliminated variables that were found to be insignificant in the model, till left with significant variables only. This process was augmented by chi square tests and analysis of variance (ANOVA) to ascertain model fitness.

Ordinary Least Squares Regression

The Statistical Software package for Social Sciences (SPSS v.25) was used to capture and analyse the data collected. The Ordinary Least Squares (OLS) Regression analysis was applied as the data had more than one independent variables that determine outcome. It was used to measure the difference between respondents whose firms had been recording stunted growth and those recording significant growth following MFI intervention. In any regression analysis the key quantity is the mean value of the response variable given the values of the independent variable. Following the recommendation of Allison (2002) it was recognised that including more than one explanatory variable in the model does not indicate the absence of missed variables from the model. Consequently, a disturbance term was included in each model to minimize the effect of missed variables from the model as shown in the general model below:

Equation 1

$$Y = \alpha + \beta nX + \varepsilon$$

where:

Y = SE Financial Performance

α =constant,

β = vector of regression coefficients,

X =matrix component of independent variables (Challenges faced by MFIs in promoting SE financial performance),

ε = the error term.

The modified OLS model used the following equation:

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \dots \beta_n X_n + \varepsilon$$

where:

Y stands for the function of the independent variables,

α is the constant of regression,

$\beta_1, \beta_2, \beta_3, \beta_4, \dots, \beta_n$ are coefficients of regression,

ε is an error term.

RESULTS AND DISCUSSIONS

4.1 Demographics

The research sought to gain an understanding of the respondents' demographic profiles by posing questions that solicited responses on their gender, age and experience in their current positions. The respondents were the MFI Heads or representatives. Table 2 below tabulates the demographic information of the targeted research group.

Table 2: Demography

Gender	Female	29	45.3
	Male	35	54.7
	Total	64	100.0
Age	25 - 35years	27	42.2
	36 - 45years	20	31.3
	46 - 55years	12	18.8
	56 - 65years	5	7.8
	Total	64	100.0
Experience	0 - 5years	33	39.1
	6 - 10years	25	51.6
	11 - 15years	5	7.8
	Over 16 years	1	1.6
	Total	64	100.0

4.2 SE Financial Performance

The questionnaire sought to solicit for the MFIs' perspectives on the general outlook of their clients' (SEs') financial performance. Table 3 below summarises the views obtained from the MFI Heads or representatives.

Table 3: SE Financial Performance

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Declining	10	15.6	15.6	15.6

No change	19	29.7	29.7	45.3
Improving	35	54.7	54.7	100.0
Total	64	100.0	100.0	

The MFIs indicated that most of the SEs they were serving were recording improving (55%) financial performance.

4.3 Analysis of the factors/variables-Regression Analysis

The use of Stepwise regression as a move to identify the significant factors influencing the MFIs' ability to enhance the financial performance of SEs resulted in several models being computed per each step, when insignificant factors were being eliminated. The results are shown in the model summary.

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.911 ^a	.830	.794	.339
2	.911 ^b	.830	.798	.336
3	.911 ^c	.830	.802	.333
4	.911 ^d	.830	.805	.330
5	.908 ^e	.824	.802	.333

The multiple correlation coefficient (R) for all the models ranged from 0.908 to 0.911 denoting a good level of prediction for all models. Further, the coefficient of determination (R^2) for each model ranged from 0.794 to 0.805 signifying that the selected independent variables explained more than 79% of the dependent variable's variability.

Table 4: ANOVA

ANOVA ^a						
Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	29.256	11	2.660	23.132	.000 ^b
	Residual	5.979	52	.115		
	Total	35.234	63			
2	Regression	29.256	10	2.926	25.934	.000 ^c
	Residual	5.979	53	.113		
	Total	35.234	63			
3	Regression	29.254	9	3.250	29.348	.000 ^d
	Residual	5.981	54	.111		
	Total	35.234	63			

4	Regression	29.238	8	3.655	33.520	.000 ^e
	Residual	5.997	55	.109		
	Total	35.234	63			
5	Regression	29.037	7	4.148	37.486	.000 ^f
	Residual	6.197	56	.111		
	Total	35.234	63			

From the ANOVA table it can be seen that significance level is $0.000 < 0.05$ for each model, which shows that the OLS model is valid because p-value is less than 0.05. As such, the regression model was a good fit for the current data.

Stepwise Selection of Significant factors

The stepwise selection method starts with a model with all the variables and eliminates them one by one depending on the significance of their coefficients. The backward selection was applied and the results are presented in the subsections from Step 1 to Step 5.

Step 1

Table 5: Step with all the factors

Step 1	Factors	Significance
	Diversion of loans by SEs beneficiaries	.081
	Adequate liquidity in MFIs	.004
	High competition in market	.041
	Clear plans among the SEs	.016
	Information access among the SEs	.000
	Lack of collateral among SEs	.000
	Limited training among the SEs	.000
	Fraud among SEs	.900
	Unregistered SEs	.987
	Strict terms and conditions	.697
	Ineffective leadership in the SEs	.265

Step 1 had all the eleven factors identified from the preliminary survey as having an effect on MFIs' ability to influence SE financial performance. Therefore, on Step 1 there was no elimination of variables.

Step 2

Table 6: Step 2 Elimination of 'Unregistered SEs'

Step 2	Factors	Significance
	Diversion of loans by SEs beneficiaries	.032
	Adequate liquidity in MFIs	.004
	High competition in market	.039

Clear plans among the SEs	.014
Information access among the SEs	.000
Lack of collateral among SEs	.000
Limited training among the SEs	.000
Fraud among SEs	.899
Strict terms and conditions	.694
Ineffective leadership in the SEs	.257

Step 2 shows the elimination of ‘Unregistered SEs’ as it was highly insignificant with p-value of 0.987 (>0.05). Therefore, though the body of literature and some participants highlighted the possibility of MFIs activities to be influenced by activities of ‘Unregistered SEs’, in the current study it was found to have an insignificant effect.

Step 3

Table 7: Step 3 Elimination of ‘Fraud among SEs’

Step 3	Factors	Significance
	Diversion of loans by SEs beneficiaries	.003
	Adequate liquidity in MFIs	.001
	High competition in market	.036
	Clear plans among the SEs	.014
	Information access among the SEs	.000
	Lack of collateral among SEs	.000
	Limited training among the SEs	.000
	Strict terms and conditions	.706
	Ineffective leadership in the SEs	.177

Step 3 shows the elimination of ‘Fraud among SEs’ as it was highly insignificant with p-value of 0.899 (>0.05). Despite having been identified in the preliminary survey, and highlighted by some participants, ‘Fraud among SEs’ was found to have an insignificant effect on SE financial performance.

Step 4

Table 8: Step 4 Elimination of ‘Strict terms and conditions’

Step 4	Factors	Significance
	Diversion of loans by SEs beneficiaries	.002
	Adequate liquidity in MFIs	.000
	High competition in market	.033
	Clear plans among the SEs	.012

Information access among the SEs	.000
Lack of collateral among SEs	.000
Limited training among the SEs	.000
Ineffective leadership in the SEs	.181

Step 4 shows the elimination of ‘Strict terms and conditions’ as it was highly insignificant with p-value of 0.706 (>0.05). Despite having been identified in the preliminary survey, and highlighted by some participants, in the current study, ‘Strict terms and conditions’ was found to have an insignificant effect on SE financial performance.

Final Step-Significant factors

The final step presents data on the factors that were found to be significant in influencing MFI activities targeted at influencing SE financial performance.

Table 9: Final Step-Significant factors

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
5 (Constant)	2.550	.325		7.852	.000
Diversion of loans by SEs beneficiaries	-.228	.059	-.310	-3.883	.000
Adequate liquidity in MFIs	.218	.044	.352	4.905	.000
High competition in market	-.148	.067	-.284	-2.216	.031
Clear plans among the SEs	.154	.059	.316	2.598	.012
Information access among the SEs	.752	.084	1.112	8.971	.000
Lack of collateral among SEs	-.640	.098	-.769	-6.539	.000
Limited training among the SEs	-.307	.048	-.569	-6.462	.000

a. Dependent Variable: SE Financial Performance

The table shows the factors that were used to come up with the final model.

The fitted model becomes:

$$Y = 2.550 - 0.228x_1 + 0.218x_2 - 0.148x_3 + 0.154x_4 + 0.752x_5 - 0.640x_6 - 0.307x_7 + \epsilon$$

where:

x_1 is Diversion of loans by SEs beneficiaries

x_2 is Adequate liquidity in MFIs

x_3 is High competition in market

x_4 is Clear plans among the SEs

x_5 is Information access among the SEs

x_6 is Lack of collateral among SEs
 x_7 is Limited training among the SEs

Interpretation

The results show that an increase in the following factors results in a reduction in the financial performance of SEs: Diversion of loans by SEs beneficiaries (coefficient=-0.228); Competition in the market (coefficient=-0.148); Lack of collateral amongst SEs (coefficient=-0.640) and Limited training amongst the SEs (coefficient=-0.307). Therefore, an increase in any of these factors significantly hinders the efforts of MFIs targeted at enhancing SE financial performance. It was also shown that an increase in the following factors results in an improvement in SE financial performance: Adequate liquidity in MFIs (coefficient=+0.218); clear plans among the SEs (+ 0.154) and information access among the SEs (coefficient=+ 0.752). Therefore, a decline in any of these factors significantly hinders the efforts of MFIs targeted at enhancing SE financial performance.

Ranking with descending order of impact

The factors identified as having significant influence on MFIs efforts to enhance SE financial performance were ranked in order of impact and significance.

Table 10: Final Ranking

Factors	Impact	Significance	Rank
Information access among the SEs	+0.752	0.000	1
Lack of collateral among SEs	-0.640	0.000	2
Limited training among the SEs	-0.307	0.000	3
Diversion of loans by SEs beneficiaries	-0.228	0.000	4
Adequate liquidity in MFIs	+0.218	0.000	5
Clear plans among the SEs	+0.154	0.012	6
High competition in market	-0.148	0.031	7

The results show that information access amongst SEs ranked as first followed by lack of collateral, limited training and diversion of loans by SE beneficiaries. Adequate liquidity in MFIs, clear plans amongst SEs and high competition in the market had least impact. This imply that improving information access amongst SEs, addressing collateral issue, providing adequate training to the SEs and addressing the diversion of loans among SEs may help to obtain significant positive impact on SE financial performance through MFI activities.

CONCLUSIONS

The study concludes that although MFIs have the potential to unlock economic emancipation and global competitiveness for developing countries through fostering SE growth and development, the following variables, in their order of significance contribute immensely to the intricacy associated with MFIs' efforts to promote small enterprise growth and development in Zimbabwe: information access amongst SEs, lack of collateral, limited training, diversion of loans by SE

beneficiaries, adequate liquidity in MFIs, clear plans among SEs and high competition in the market. The study therefore recommends the adoption of a comprehensive SE micro-financing approach, whereby cognisance is placed on the above variables. We notice the need for improving information access amongst SEs, addressing the collateral issue, providing adequate training to the SEs and addressing the diversion of loans amongst SEs. On most of the issues, that is information access, training, loan diversions amongst SEs and clarity in SE planning, we strongly endorse the Entrepreneurship Development Centre (EDC) approach suggested by Hosho, Muguti and Muzividzi (2015) for the total development of fully equipped players in the private sector, particularly the SE sub-sector. We recommend further studies to focus on developing the approach into a fully-fledged conceptual framework for the development of responsible and capable entrepreneurs and SE managers. We consider that with fully functional EDCs, MFIs can successfully shift from the impeding tangible asset collateral to the competence-based collateral whereby a fully trained SE head with all the required technical competence becomes the surety even for a start-up SE with no tangible assets.

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