

**INFLUENCE OF MICRO DETERMINANTS ON FINANCIAL PERFORMANCE  
OF MICROFINANCE INSTITUTIONS IN NAIROBI COUNTY, KENYA**

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of the Requirements for the Conferment of the Degree of Masters of Business  
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## **DECLARATION AND RECOMMENDATION**

### **Declaration**

I declare this thesis is my original work that has never been presented in any other university for award of any degree.

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### **Recommendations**

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## **DEDICATION**

This work is dedicated to my husband Muriuki and my children Rita, Joy and Lynn  
Neema. They have always supported me during this study

## **ACKNOWLEDGEMENT**

I give special thanks to Almighty God for so many blessings including time, a healthy life to undertake this study and the entire course. I cannot fail to thank my supervisors Dr. Nancy Rintari, Ph.D. and Dr Wilson Muema, Ph.D. who have been instrumental in making this proposal a success. My appreciations go to my immediate family who include my husband Muriuki and my children Rita, Joy and Lynn Neema for providing moral and financial support during my postgraduate studies. My sincere gratitude also goes to the Kenya Methodist University, the School of Business and Economics and library staff for guidance in search of materials that were necessary in writing this proposal. Further, I thank my classmates at the Kenya Methodist University and colleagues at work, close friends and my family who in various ways assisted me during the study.

## ABSTRACT

MFIs have a goal of accepting client's deposit and act as financial lenders such that they operate within the laid down policy structure. This structure should be developed by highly experienced board members whose decisions influence positively the general direction of the operations. The general objective of the study was to determine the influence of micro determinants on financial performance of microfinance institutions in Nairobi County, Kenya. The specific objectives were to assess the influence of capital structure, product diversification, credit risk management and board members' composition on financial performance of microfinance institutions in Nairobi County, Kenya. The study was guided by three theories whereby pecking order theory guided capital structure, resource-based view theory guided product diversification and composition of board members; and credit risk theory guided credit risk management variable. Notably, the study applied descriptive research design during the collection of data. The study's target population was 14 microfinance banks registered and regulated by the CBK. Further, the respondents were 19 operations managers, 34 tellers, 40 credit officers, and 28 customer care officers. The study collected primary and secondary data whereby close-ended questionnaires and secondary data collection form was used respectively. The study conducted a pre-test study of the questionnaires in Cooperative bank and I&M banks in Nairobi County. Further, the study tested reliability through the Cronbach Alpha coefficients. Notably, the study assessed criterion, construct and face types of validity. Further, quantitative data was analyzed using SPSS software version 25 to generate descriptive and inferential statistics. The various descriptive analysis was frequencies, percentage and mean, while linear and multiple regression analysis was done as part of inferential statistics analysis. The conclusion made on capital structure was that MFIs' management had failed to balance between raising their capital from the share capital and other forms of funding. On product diversification, the management failed to incorporate various improvement suggestions made on the different implemented products. On credit management, there were poor debt recovery methods in the branches leading to numerous default rates. On board members, they lacked a policy framework on the frequency and range of timelines when decision should be made and if they did, they did not put it into practice. The study recommends on capital structure that the MFIs' board of management should provide a reliable policy framework on payment structure. On product diversification, the management of MFIs should commission a special committee of expert to review the requirement of each and every product being offered. On credit management, there should be a thorough audit of the ICT financial systems used by the MFI to ensure that it works seamlessly. On board members composition, there should be a clear framework developed through a consensus meeting with shareholders' representative.

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## **ABBREVIATIONS AND ACRONYMS**

<b>AMFIK</b>	Association of Microfinance Financial Insititutions in Kenya
<b>CBK</b>	Central Bank of Kenya
<b>EU</b>	European Union
<b>GDP</b>	Gross Domestic Product
<b>IMF</b>	International Monetary Fund
<b>KYC</b>	Know Your Customer
<b>MFI</b>	Microfinance institutions
<b>ROA</b>	Return on Assets
<b>ROE</b>	Return in Equity
<b>SEM</b>	Structural equation modeling
<b>UNECA</b>	United Nations Economic Commission for Africa

# **CHAPTER ONE**

## **INTRODUCTION**

### **1.1 Background of the Study**

Microfinance Institutions [MFIs] are financial organizations established to allow deposits and lend micro-credits low-income borrowers (Association of Microfinance Financial Institutions in Kenya [AMFIK], 2023). These institutions are key to the development of any economy since they link low-income borrowers to financial support that would help them in investing in various businesses. Additionally, they also offer sound financial advisory to their clients on the various ways they could invest their wealth in purchase of securities (Guizani, 2020). Further, the institutions offer deposit and savings accounts solutions that are payable with interest hence providing a safe place to store huge amounts of personal finances.

Globally as per Ssekiziyivu et al. (2017) MFIs are critical to the economy of Pakistan in that they improve the degree of exchanging practices the region. However, Ssekiziyivu et al. (2017) note that performance of MFI is undermined by the low capital enrichment, high pace of default rates and fierce opposition from the average banks. In Asia, the performance of the MFI is impacted by the institutional prerequisites (Lam et al., 2019). This means that performance of MFIs is looked as a measure of financing many elements. Maybe, this can be credited to the idea of the business they work in. The financial sector is directed because of the way that it manages a wide population. Hence, MFIs are in many cases under severe functional rules to safeguard the savings (Njeru et al., 2015).

Regionally, In Ethiopia, MFIs are essential in that they make it workable for the poor to contribute in country building (Mohammed & Wobe, 2019). In any case, the monetary performance of the MFI is impacted by size of clients served, low monetary limit and a quickly evolving climate (Mohammed & Wobe, 2019). Therefore, it is consistent with the internal and external culture of the MFI's foundations and its ability to increase revenue. That notwithstanding, repayment of loans among MFIs in Uganda is low and subsequently prompting low benefit because of loss of interest paid and principal because of credit defaults.

Locally in Kenya, the MFIs are regulated by the CBK under the Microfinance Act of 2006 (Central Bank of Kenya [CBK], 2021). The Act defines what activities MFIs can engage in and sets the term for issuance of licenses to such financial institutions. It is important to note that MFIs are not strictly commercial banks but are supposed to adhere to similar legal requirements as those followed by commercial banks (AMFIK, 2023). For this reason, the day-to-day operations of the microfinances ought to be in line with the requirements of Act and other requirements as stipulated by the Central Bank of Kenya.

### **1.1.1 Micro Determinants**

Micro determinants are vital elements applied in the cause of doing banking business to improve performance (Orichom & Omeke, 2021). There are very many such kind of elements however, the study examined the capital structure, product diversification, credit risk management and board composition (Abu-Rumman et al., 2021; Ishmail et al., 2023; Maranga et al., 2022). Capital structure is the composition of both debt and equity that an MFI uses to ensure that it has sound financial base (Bibi et al., 2022). Product diversification is the process through which MFIs broadens the revenue sources through

introducing different deposit accounts, saving accounts and loans in their operations (Maranga et al., 2022). Credit risk management is the process of assessment of borrowers, extension of credit, monitoring the loan payments to ensure that the default rates are minimized (Orichom & Omeke, 2021). Board members' composition entails the key decision makers in an MFI and how their suggested financial policies affect the MFI operations (Sheikh et al., 2021).

Notably, micro determinants dictate a lot on how an MFI would make financial decision that involve selling various products to generate revenue. The ability to have robust funding determines how well products and services would be developed till they are implemented. It required a combination of both share capital in place and how efficient would the MFI raise money through floating bonds and other debt means. Additionally, once the capital structure is in place, it takes articulate decision making to also create different products such as loans, deposit accounts, savings accounts and securities (Mehmood et al., 2019). These products ensures that there is an all-round diversification of income to see to it there is profitability. Further, as the MFIs are implementing financial policies and selling various products such as loans, they do so with clear credit risk management.

This is done to ensure that any money issued as loans, it is paid amicably and with interest. Notably, the success of all these aspects such as sound capital structure, diversified income, and robust credit management system is pegged on the composition of the board members (Ewool & Quartey, 2021). These are the individuals responsible in making decision that affect each and every part of the MFIs' operations. Therefore, all these four micro determinants have to work hand in hand to ensure that performance improves and in a great

way. Still in this line of thought, MFIs globally, regionally and locally have put effort to ensure that various micro determinants applied become effective.

Globally, MFIs have intensified more customized financial products and services such as loans, current and savings accounts (Parvin et al., 2022). Additionally, there have been appointment of highly experienced board members in financial matters and investment in current ICT system to monitor borrowers (Ngo et al., 2023). Regionally, there has been implementation of financial policies that promote integrity in banking processes (Asare et al., 2021). Further, there have been recruitment of qualified credit officers who have borrower assessment skills and floating of bonds so as to acquire more capital to fund their operations (Deyganto, 2021). Locally, MFIs have encouraged training and development on financial securities to capitalize on improving that source of income (AMFIK, 2023). They have also entered in partnership with various government and non-government corporates to raise awareness on MFIs products and services (Wangombe & Kibati, 2019).

### **1.1.2 Financial Performance**

Financial performance is the assessment of the financial health of an MFI such that it's able to funds operations drawing revenue from various sources (CBK, 2021). There are different ways to measure performance such as Return on Asset [ROA], Return on Equity [ROE], Return on Investment [ROI], capital adequacy ratio, Gross profit, and Net profit among others. Nevertheless, this study measured performance using ROA, ROE, gross profit and net profit (CBK, 2021). This is because these are major aspects that have been used by CBK as financial metrics in assessing MFIs. Regrettably, these institutions have encountered several challenges (CBK, 2021).

Globally, MFIs in nations such as American states such as Georgia have experienced high employee turnover due to unrealistic demands raised by the management (International Monetary Fund [IMF], (2020). In European nations like Sweden, there has been reduced number of MFI's client and also poor support from the management towards regulating capital sufficiency levels (European Union [EU], 2021). In Japan, there has been increased demands from regulators and taxations from government (Bank of Japan, 2019).

Regionally, MFIs in Nigeria have been struggling with low liquidity concerns due to poor uptake of products by clients (United Nations Economic Commission for Africa [UNECA], 2020). In Ghana, there has been low awareness on the various financial products that MFIs have. In South Africa, there has been low female gender representation in the board hence biased decisions which affect the overall operations of the MFIs (Mandipa & Sibindi, 2022). In East African nation such as Rwanda, MFIs have experienced increased operational costs whose impact towards increased revenue has been low; low training of staff to manage leverage, whereas in Tanzanian MFIs, there has been. high level of corruption whereby people have to pay officers to be qualified for loans they do not qualify (Kamchape, 2020).

Locally in Kenya, the asset quality of MFIs has declined and insufficient policies that covers the extent of leverage taking. Further, MFIs have also struggled with high bureaucracy from the board to a point that financial decision making becomes too complicated (Nyawira, 2021). Additionally, MFIs have been battling with competition from other financial institutions such as commercial banks. Notably, MFIs have been struggling with low dividend payouts to shareholders and high default rates on issued non-performing loans.

### **1.1.3 Microfinance Institutions in Kenya**

The Kenyan financial system incorporates fourteen MFIs that operate under close regulations of the CBK since they deal with accepting deposits and lending to citizens (CBK, 2021). These financial institutions have encountered poor quality assets and declining customer numbers. Further, they have experienced unending competition from rival financial institutions to the extent of being pushed to close their branches such as the case of Faulu MFI closing its Makutano-Meru branch, Meru town branch and Maua branch at the same financial year (Otieno, 2022). It is also worrying that among all major financial institutions in Kenya, it is only MFIs that have the lowest number. Therefore, it is rather obnoxious that the 14 MFIs have suffered from poor penetration to a point that other financial institutions such as Saccos have overtaken them in provision of affordable finance to low-income earners.

### **1.2 Statement of the Problem**

MFIs have a goal of accepting client's deposit and act as financial lenders such that they operate within the laid down policy structure. This structure should be developed by highly experienced board members whose decisions influence positively the general direction of the operations (Era, 2019). Additionally, they should have adequate capital structure that comprises of both debt and equity to implement various products to the customers. An increased uptake will promote raised revenue hence high liquidity (AMFIK, 2023). Notably, they should also ensure that disbursed loans are only issued to qualified clients to minimize credit risks hence improving the overall financial performance.

Nevertheless, the MFIs in Kenya have been experiencing high non-performing loans and as well as declined assets and low client deposits numbers (CBK, 2021). This is whereby the deposit made by the customers declined by Kshs 2.8 billion to be 48 billion in 2022 from 50.8 billion in 2021. This was partially caused by insufficient product diversification aspects like high interest rate earning deposit and savings accounts. Further, the report indicated that there was a decline of total assets by 1 percent in the year ended December 2021 to Kshs. 73.9 billion from 74.9 billion in 2020. This attribute was caused by unreliable capital structure to support the operations of the MFI hence most of the assets negatively affected through being converted to cash pre-maturely.

In a similar period, net advances declined by 9% to Kshs. 40.1 billion from Kshs. 44.2 billion in the year 2021 and 2020 respectively (CBK, 2021). The non-performing loans were mainly affected by increased credit risk of default from various loan clients. A number of authors have attempted to assess factors that influence firm performance in MFIs. Internal factors like size, efficiency, risk, and loan size influenced the financial performance of Pakistani MFIs (Naz et al., 2019). Despite its usefulness, the study leaves a gap in context because it was conducted in the Middle East, whereas the current one will be conducted in East Africa. Poor credit risk management and an inefficient capital structure are to blame for the low financial returns and low viability of MFIs in Uganda (Orichom & Omeke, 2021). However, according to Bengi & Njenje (2016), financial literacy was found to be the most important factor in MFIs' performance in the Bahati Sub-County in Kenya.

In addition, Ngumo et al. (2017) looked at the factors that influence performance of MFIs in Kenya. According to their research, bank performance was influenced by factors such

as microfinance size, adequate capital and reserves, and operational efficiency. A study by Ngina (2017) sought to identify the factors that influence MFIs' financial performance in Nairobi. According to the study, firms' performance was positively impacted by share capital reserves, credit risk management, capital structure (leverage), and market portfolio. The study failed to assess composition of the board members and product diversification. Having noted this gap in literature, this study will seek to determine the influence of micro determinants on financial performance of microfinance institutions in Nairobi County, Kenya.

### **1.3 General Objective**

To determine the influence of micro determinants on financial performance of microfinance institutions in Nairobi County, Kenya.

### **1.4 Specific Objectives**

- i. To assess the influence of capital structure on financial performance of microfinance institutions in Nairobi County, Kenya.
- ii. To examine the influence of product diversification on financial performance of microfinance institutions in Nairobi County, Kenya.
- iii. To establish the influence of credit risk management on financial performance of microfinance institutions in Nairobi County, Kenya.
- iv. To evaluate the influence of board members' composition on financial performance of microfinance institutions in Nairobi County, Kenya.

## **1.5 Research Hypothesis**

H<sub>0</sub>1: Capital structure did not have a significant influence on financial performance of microfinance institutions in Nairobi County, Kenya.

H<sub>0</sub>2: Product diversification did not have a significant influence on financial performance of microfinance institutions in Nairobi County, Kenya.

H<sub>0</sub>3: Credit risk management did not have a significant influence on financial performance of microfinance institutions in Nairobi County, Kenya.

H<sub>0</sub>4: Board members' composition did not have a significant influence on financial performance of microfinance institutions in Nairobi County, Kenya.

## **1.6 Significance of the Study**

The study's findings would benefit the management team in assessing how various financial related decisions on policies and products have influenced performance. This would thus enable them understand how they could brainstorm with the board members on areas of improvement on products, capital structure and credit management.

The regulators would also be informed on how various government policies have affected the performance of MFIs. Therefore, they would understand how harsh regulations are limiting more MFIs to join the banking system. Therefore, they could eliminate any unreliable regulations and strengthen the working ones.

The study would also benefit clients since they would understand how MFIs operate and the factors affecting performance. In this regard, the clients would understand how their

regular deposits and savings enabled the MFIs experience growth. Additionally, the clients would also get knowledge on how defaulting loans negatively impacts performance.

The competitors of MFIs could also use the results to examine the various credit management strategies used, nature of products diversifications, percentage of various attributes of capital structure and qualifications of the board members. This information could be used to adopt some of the attributed in their banking systems to improve their performance as well. Through doing this, it would improve the banking sector hence positively affecting the economy through the Gross Domestic Product [GDP].

Future researchers would also use the findings to pin-point the various issues MFIs in Kenya have undergone as far as their performance is concerned. This would enable them advance studies to ascertain whether these performance related issues were only unique to MFI but if could be related to other financial institutions. The findings would contribute to the field of finance immediately the results are known.

### **1.7 Scope of the Study**

This study was steered in Nairobi County and assessed the influence of micro determinants on financial performance of 14 MFIs. It covered various aspects such as capital structure, product diversification, credit risk management, and board members' composition. The respondents were 24 operations managers, 53 tellers, 68 credit officers, 40 customer care officers hence a sum of 185 respondents. The study collected quantitative data using self-administered questionnaires which are closed-ended in nature. Further, the study also used secondary data collection form to gather information on financial performance metrics such as ROA, ROE, gross profit and net profit. This information was from audited financial

reports such as income statements and balance sheets. The secondary data was collected for a 5-year period beginning from 2018 to 2022. The study took 3 months to complete.

### **1.8 Limitations of the Study**

The study was restricted since a portion of the reports of MFIs could be unaudited consequently raising vulnerability issue particularly on financial concerns in certain years like in 2020 when there was covid-19. However, the researcher liaised with the MFI's management and accessed valid records through an approval letter. This enabled the study to be able to identify correct financial performance values such as ROA, ROE, gross profit and net profit.

### **1.9 Assumptions of the Study**

The assumptions for this study were that there were different financial products offered at the MFIs for various purposes. Further the MFIs had received at least three changes in policies emanating from the decision made by the board members. Additionally, there had been cases of floated shares as an indicator that the MFIs want their capital structure improved.

## **1.10 Operational Definition of Terms**

### **Board Members' Composition**

Board members' composition entails the key decision makers in an MFI and how their suggested financial policies affect the MFI operations (Sheikh et al., 2021).

### **Capital Structure**

This is the composition of both debt and equity that an MFI uses to ensure that it has sound financial base. (Bibi et al., 2022).

### **Credit Risk Management**

This is the process of assessment of borrowers, extension of credit, monitoring the loan payments to ensure that the default rates are minimized (Orichom & Omeke, 2021).

### **Financial Performance**

Financial performance is the assessment of the financial health of an MFI such that it's able to funds operations drawing revenue from various sources (CBK, 2021).

### **Micro Determinants**

These are vital elements applied in the cause of doing banking business to improve performance. (Orichom & Omeke, 2021).

### **Microfinance Institutions**

They are financial organizations established to allow deposits and lend micro-credits low-income borrowers (AMFIK, 2023).

## **Product Diversification**

Product diversification is the process through which MFIs broadens the revenue sources through introducing different deposit accounts, saving accounts and loans in their operations (Maranga et al., 2022).

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.1 Introduction**

The chapter covers the theoretical review and empirical review based on each of the independent variables. Thereafter, the chapter provide the conceptual and operational framework.

#### **2.2 Theoretical Review**

The study was guided by three theories whereby pecking order theory guided capital structure, resource-based view theory guided product diversification and composition of board members; and credit risk theory guided credit risk management variable.

##### **2.2.1 Pecking Order Theory**

Myers and Majluf (1984) developed this theory and it guided capital structure variable. It indicates that as an organization is looking for financing options, it should consider internal sources before proceeding to external sources. This is because internal sources are cheaper compared to external ones and also they are not easily affected by market related risks. This means that when an organization would wish to fund their operations, they had different options that they could use emanating from retained earnings, donations, debt and shares among others based on the nature of the business they are neaged in. The main guideline towards deciding on which type of financing an institution would wish to adopt, it depended on the cost of financins and actual need on whether it was a capital or a recurrent expenditure.

Therefore, in relation to the capital structure variable, MFIs performance was mainly attributed to how the management decided on where funding would come from. The order suggested was that, if it could be funded using retained earnings then it would be the best option to consider. However, at times the MFI would want to fund a capital expenditure or a recurrent expenditure but on a large scale. In such scenarios it was advisable that funding from debt such as from bonds were to be considered followed by floating shares. Therefore, this means that an MFI decision to accept a funding system was highly based on the need and whether it could use internal funding first then external funding. According to Myers and Majluf (1984), share capital was considered the last option since the incorporating new owners meant that the management system and decisions could be easily affected. In terms of debt, the interest charged was a key determinant whether it was worth the effort. For example if interest proposed to pay the bond subscribers was extremely high and exposed to inflation risk, it could be considered too expensive to sustain hence the risk of the MFI defaulting the agreement.

Pecking order theory had a weakness as indicated by Guizani (2020) that it assumed that financing had to begin with internal then external which in real world at times become impractical. This was because some firms preferred debt as a source of financing their operations. Additionally, Guizani (2020) indicated that the theory only considered reserves, debt and share capital but not any other modern sources such as from capital market. However, this weakness had no effect since main indicators that the study set to address were related to common stock, debt structure, preference stock and retained earnings.

### **2.2.2 Resource-Based View Theory**

Wernerfelt (1984) advanced this theory and it guided product diversification and composition of board members variables. It indicates that any institution, has tangible and intangible resources through which when maximally utilized, enables the organization attain its objectives, mission and vision. The tangible resources include physical aspects such as reserves, machinery, stationery, buildings, vehicles, and stock. The intangible resources include good will, organization culture and employees qualification in terms of experience and academic qualifications. All these elements when properly utilized, they result to increased revenue and the institution's existence for a long time in the business.

Therefore, product diversification in MFIs which entailed having different types of deposit accounts, savings accounts, insurance accounts and loans, was a type of tangible resource that could be used to improve performance. This was because when clients discovered that they had different options to use in keeping their money to earn interest and also access various types of loans, they were motivated to even invite their friends and family. As a result when the deposit and savings accounts were loaded with client's money, the MFI was able to utilise these resources in various operations to improve their performance.

In relation to board members' composition, it involved considering aspects such as their diversity, skills, attributes, experience, networks and decision making process. If an MFI appointed a board member with adequate financial knowledge and skills this came in handy towards guiding on various policy measures of operations. Others could be appointed based on how connected they were in terms of networks. This could be in terms of high worth local and international clients that they could bring on board to raise the capital structure of the institution. Additionally, there could be other board members with wealth of

experience on how to improve the performance of a product that is not attracting clients. This enabled the MFI develop, implement and monitor the progress of their products from an experience point of views hence low chances of low sales.

Further on, according to Priem and Butler (2001), it didn't depict a clear explanation of how resources brought about improved performance of a firm. However, based on the current study's variables such as product diversification and composition of board members, past authors such as Maranga et al. (2022) had provided the explanation that they had a positive influence on performance.

### **2.2.3 Credit Risk Theory**

This hypothesis was progressed by Merton (1974) and it directed credit risk variable. It sees default as put choice accessible when situation is financially appealing to the borrower to practice the default choice. This means that over the life of a debt, a borrower could default at any time as long as they are pressed hard by the economy. Therefore, in relation to credit risk management, MFIs developed various structures that enabled it to assess borrowers, develop loan payment policies, monitor disbursed loan and instigate customized options to entice defaulter to continue their payments such as extending the payment terms.

These measures were to ensure that any default probability was lowered to the minimal points. A default could paralyse the operations of an MFI since the institutions' money was withheld by someone who did not want to pay it back. Therefore, the bank employed various techniques which included monitoring, threats and finally auction or legal process against a client. These methods were administered based on the severity of the default situation. For example if a client had defaulted due to job loss, the measures applied could

be related to extension of terms, offering of grace period for payments. However, if no convincing reason was given for default, threats and auction took effect.

These measures were instigated to ensure that clients took full responsibility of the loans they applied for irrespective of whether they were experiencing economic hardships or not. Nevertheless, assessment of borrowers before issuing a loan was paramount so that the facility was given to qualified borrower and who had the ability to reimburse the credit with interest. It was therefore of essence that issuing of loan became a process that required a review from two or more MFIs' staff who would identify any taint in the borrower's application process hence denying them the facility before its too late.

### **2.3 Capital Structure and Financial Performance**

This is the composition of both debt and equity that an MFI uses to ensure that it has sound financial base (Bibi et al., 2022). It had indicators such as common stock, debt structure, preference stock, and retained earnings. Common stock is a group of shareholders who have purchased shares at lower prices and hold the right to vote in every decision (Orichom & Omeke, 2021). Preference stock contains another group of shareholders whose shares are more expensive than common stock (Wangombe & Kibati, 2019).

The preference shareholders do not have the right to vote but get paid dividends first before the other types of shareholders. Debt structure entails the methods used by an MFI to raise funds which include borrowing from other banks and raising bonds among others (Deyganto, 2021). Retained earnings are reserves set aside after shareholders have been paid to ensure that the MFI has enough money to absorb any economic shocks. Authors

have debated on the how capital structure influences financial performance as detailed in the next paragraphs.

Notably in Asia, Bibi et al. (2022) evaluated the kind of influence that the performance of the MFIs was impacted by the structure of capital. Two hundred and fifty-three MFIs' reports from 2000 to 2015 were analyzed. The discoveries uncovered that there was a positive impact of the capital structure's elements like debt, equity, and reserves on performance. However, the Bibi et al. (2022) used a qualification criterion where the MFIs included in the study, had over 1.3 million assets worth hence did not include those of less worth.

Further in Bangladesh, Parvin et al. (2022) conducted a study to ascertain how the MFIs' performance was affected by the structure of capital adopted. A dataset of one hundred and eighty-seven MFIs was used whereby the debt, deposits, loans and equity formed the capital structure. The results revealed that equity, debt had a positive influence on performance whereas deposit and loans had a negative influence on performance as far as capital structure was concerned. Notably, Parvin et al. (2022) did not assess other capital structure aspects such as retained earnings.

Additionally, in Ethiopia, Deyganto (2021) examined the various determinants of MFI's capital structure. Through the use of purposive sampling method, the study derived 8 MFIs that had been in existence for over eight years. According to Deyganto (2021), growth, profitability, firm size, age, and asset tangibility had an influence of capital structure. Nevertheless, the study used pecking order theory as part of theoretical framework which has a weakness as indicated by Guizani (2020) that it assumes that financing has to begin

with internal then external which in real world at times become impractical. This is because some firms prefer debt as a source of financing their operations.

Further in Uganda, Orichom and Omeke (2021) assessed how MFIs' performance was influenced by the structure of capital and management of credit risk. The study adopted a cross-sectional approach to include sixty-four MFIs in the study that were operational. The polls were utilized as the fundamental information assortment instruments. The review surveyed value and obligation parts of capital structure on monetary performance measurements such as quality of portfolio and efficiency in operations. According to Orichom and Omeke (2021), capital structure did not have any influence on performance. However, majority part of MFIs considered which were 29(45.3%) of the sample size were unregulated ones and 22(34.4%) from Saccos. This therefore indicated that there was a high likelihood the study collected data from a mixture of wrong population which therefore affected the results negatively. Additionally, Orichom and Omeke (2021) did not specify who were the respondents that would answer the questionnaires.

Further in Nairobi-Kenya, Odero and Mutswenje (2021) explored how MFIs performance was influenced by the structure of capital. The study included fourteen MFIs currently in operation in Kenya with an analysis of a five-year period of data ending in 2018. The main results revealed that equity and debt had a positive influence on ROE and gross asset value. Regrettably, Odero and Mutswenje (2021) did not assess other financial performance indicators like ROA, gross profit and net profit.

Notably, Wangombe and Kibati (2019) examined how thirteen MFIs' performance was affected by the structure of the capital. Questionnaires were used to gather information on MFIs that were operational between 2013 to 2017. According to Wangombe and Kibati

(2019), retained earnings and equity sources of capital influenced performance positively whereas debt did not. However, Wangombe and Kibati (2019) did not assess preference share capital as a type of debt capital. Further, the study did not specify the respondents who would answer the questionnaires and as well as any evidence of pre-test study.

## **2.4 Product Diversification and Financial Performance**

Product diversification is the process through which MFIs broadens the revenue sources through introducing different deposit accounts, saving accounts and loans in their operations (Maranga et al., 2022). It will have indicators such as loan accounts, customer saving accounts, insurance accounts and customer deposits accounts. Loan accounts comprise of personal loans and commercial loans (Ndungu, 2019). All the loan types require a type of security to guarantee that the borrower would repay. This could come in terms of employee guarantee through certified pay slips, household item, land title deeds, and car log book among others.

Savings accounts are bank accounts that allow clients to put in money but could only be withdrawn under specific duration or conditions (Maranga et al., 2022). Deposit accounts include current accounts that clients invest their money to store for a short duration of time as compared to savings accounts (Maranga et al., 2022). Insurance accounts are accounts that allow clients to indemnify themselves or their properties in eventualities of misfortunes. Authors have debated on the how product diversification influences financial performance as detailed in the next paragraphs.

In South Asia, Mehmood et al. (2019) examined how firm performance was influenced by corporate diversification. One of the key aspects considered was the product diversification

of firms in Pakistan, India, Sri Lanka, and Bangladesh. The results revealed that having various products such as deposit accounts and loans impacted positively the performance in Pakistan, Sri Lanka, and Bangladesh while it had a negative impact in India. The explanation was that in India, there was less usage of firm assets as well as challenges related to agency. Nevertheless, Mehmood et al. (2019) did not specify which assets were underutilized nor how government regulations affected diversification of products in India's firms.

Additionally, in Nigeria, Gunu and Suleiman (2022) evaluated on how manufacturing firm performance was influenced by diversification of income. Forty-two firms' report covering an eleven-year duration ending at 2017 was used when analyzing using Structural equation modeling [SEM]. These firms were in sections such as conglomerate, real estate, consumer, industrial and natural resources. The study discovered that when a firm had different products, it improved performance. However, Gunu and Suleiman (2022) did not assess firms in motor vehicle industry.

Notably, Ndungu (2019) in Kenya, reviewed on how banks performance was influenced by diversification. One of the key objectives was to investigate how diversifying products influenced performance with the use of secondary data of previous articles from journals dating from 2013-2017. The results related to diversification of products pointed that it instigated a negative relationship with performance of commercial banks. The results are in agreement with Mehmood et al. (2019) but in disagreement with Gunu and Suleiman (2022) who dealt with manufacturing firms. There is need to expand the study and assess whether performance would improve when done on MFIs. This is because both MFIs and

commercial banks are regulated by CBK hence there is need to check whether there would a difference or not.

Further, Maranga et al. (2022) explored how Kenyan bank's profitability performed when there was the practice of diversification of products. The study involved 11 listed banks' reports from 2011 to 2020. Among the products assessed included insurance, real estate, securities and trade finance products. According to Maranga et al. (2022), all the four product diversifications had a significant influence. That noted, the gap with the study is that it conducted a pre-test in Equity bank which is also a listed bank.

## **2.5 Credit Risk Management and Financial Performance**

This is the process of assessment of borrowers, extension of credit, monitoring the loan payments to ensure that the default rates are minimized (Orichom & Omeke, 2021). It had indicators such as borrowers' assessment, loan payment policies, disbursed loans monitoring and default management such as extending payment terms. Borrower assessment encompasses having reliable internal and external structure that is used in identifying various Know Your Customer [KYC] metrics (Leja & Ibrahim, 2022). These include name, home address, work address, bank accounts details, credit background and assessment of how they intend to repay their debt.

Further loan payment policies are internal guidelines that an MFI has established to enhance the duration, amounts and repercussion of failure to pay after a specified duration. Additionally, monitoring of issued loans is the active evaluation of various payment progress of borrower credit facilities (Ewool & Quartey, 2021). The evaluation enables the assessor get a glimpse of defaulted, potentially default loans especially where the

borrowers have not paid fully and the fully paid loans. Further on, default management is the render of the last result whereby various enforcement measures are employed to force clients who have defaulted to pay (Ishmail et al., 2023). This could include auctioning, legal means or verbal warnings. Authors have debated on the how credit risk management influences financial performance as detailed in the next paragraphs.

Notably, Abu-Rumman et al. (2021) scrutinized how Jordan commercial banks' performance was affected by the management of risks related to credit, market and liquidity. Three hundred people comprised the target population that was later sampled to have one hundred and twenty-three of them. These individuals answered the questionnaires and a direct relationship between credit risk management and performance was established among all the results of the study. That is when a unit of control on credit risk was applied, performance improved by 1.6%. Notably, the banks were also established to have poor application of Basel I, II and III in borrower assessment when applying for loans. Therefore, since Abu-Rumman et al. (2021) majored on commercial bank, there is need to expand to MFIs to assess the various credit risk management methods guidelines used when assessing borrowers.

Further, Ewool and Quartey (2021) investigated how MFI's performance was affected by management of risk practices in Ghana. These practices involved identification, appraisal, control, and monitoring of risk, whereby questionnaires were the main tools of data collection from ten MFIs. Forty respondents in management, managers involved in operations, managers responsible for the branches, accountants, internal auditors, and credit officers were consulted. The results indicated that the management of risk practices were moderately applied with inconsistencies. Notably, Ewool and Quartey (2021) did not

provide further revelations on why risk management practices were moderately applied. Further, the study presented reliability results on Cronbach Coefficients without ever indicating information of pre-test study.

Additionally in Ethiopia, Era (2019) determined how the performance of MFI was influenced by the management of credit. Secondary data obtained from financial reports of 3 MFIs was used to conduct the analysis. As per the findings of Era (2019) credit risk affected negatively the performance and hence recommended that the aggressive of credit collection policies, monitor credit risk, create loan prices based on the risk they bear. However, Era (2019) did not use questionnaires in collection of data which could have been the best option to inquire on policies in place, credit monitoring methods used and the process followed when pricing loans.

In Zimbabwe, Jachi et al. (2021) explored how MFIs' stability was influenced by credit risk and the mitigation mechanisms adopted. Twelve MFIs were sampled using purposive method where credit risk management systems like dynamic inducements, loss forecasting and lending funds to groups had a negative impact on performance whereas credit scoring had a positive influence. Regrettably, Jachi et al. (2021) did not assess the various training offered to credit risk officers towards acquiring risk management skills.

Additionally, Ishmail et al. (2023) explored how performance of Kenya's MFIs was affected by credit risk. Through use of census method, secondary data from 13 MFIs was used on reports 2011-2019. Performance was assessed through ROE while credit risk was measured through non-performing loans, quality of assets and provisions made from loan loss. The results revealed that credit risk affected negatively performance hence recommended to establishment of credit management framework and rigorous policies.

In Mombasa, Leja and Ibrahim (2022) examined how MFIs' performance is influenced by management of credit risk. Questionnaires and secondary data were used to collect information from the 6 regulated MFIs in the region. According to Leja and Ibrahim (2022), thorough assessment of a client character, their payment capacity and credit score was significant towards having them honor their loan repayment contracts. Further, when there was constant monitoring of repayment terms, it minimized chances of default since any repayment issues are discovered early and remedies offered. That notwithstanding, Leja and Ibrahim (2022) only assessed deposit taking MFIs and did not include non-deposit taking MFIs.

## **2.6 Board Members' Composition and Financial Performance**

Board members' composition entails the key decision makers in an MFI and how their suggested financial policies affect the MFI operations (Sheikh et al., 2021). It had indicators such as members' diversity, financial skills and attributes, financial experience and networks and financial decision-making process such as on policies. Members diversity includes gender, religious backgrounds, ethnicity and race among others.

Financial skills and attributes include the academic and professional background that board members possess that could directly benefit the MFI (Ngo et al., 2023). Financial experience and networks entail the personal connections that a board member possess from their past which could be useful in propelling the MFIs' performance to the next level (Asare et al., 2021). Decision making process entails how quickly they board members can provide a solution to an impending problem (Sheikh et al., 2021). Authors have debated on

the how board members' composition influences financial performance as detailed in the next paragraphs.

Notably, Ngo et al. (2023) in Vietnam, assessed how performance of listed firms in capital market is affected by the independence of the board. Through use of reports dating from 2016 to 2020, the study found out that opposition from CEO such that they did not allow opinion from others, had a negative influence on performance. However, decisions made by non-executive members of the board, influenced positively performance. Therefore, according to Ngo et al. (2023), the larger the board size, the more effective the decision-making process would be due to their experience and networks hence improved performance. However, Ngo et al. (2023) did not assess how board member diversity would influence performance.

Further, Adusei (2019) explored whether the technical efficiency of the MFI is influenced in any way by the diversity of the board. Four hundred and eighteen MFIs from sixty-four nations comprised of the target population. As per Adusei (2019) diversity in terms of gender, it had a negative effect on technical efficiency, however the proportion varies depending on the size of the MFI.

Additionally, Asare et al. (2021) evaluated how African banks' performance are influenced by board structures. The study used financial reports (2007-2015) from three hundred and sixty-six banks in twenty-six African nations. As per Asare et al. (2021) the independence of the board, size and gender diversity had an insignificant influence with performance. These results are in agreement with Adusei (2019) particularly on negative influence of gender diversity on performance. Additionally, the results disagree with Ngo et al. (2023) on the positive contribution of board size to performance. However, Asare et al. (2021) did

not assess how other board member's attributes such as financial skills, experience and networks contribute to performance.

In South West Nigeria, Ademola et al. (2022) investigated how MFIs' performance was affected by corporate governance. Twelve MFIs were included whose secondary data report dating 2011-2020 was consulted. Notably, Ademola et al. (2022) established that the size and composition of the board had a positive contribution to performance. These results contradicted Asare et al. (2021) who argued that size of the board did not make any impactful contribution towards improving performance. There is therefore need to consider from the context of board composition from the Kenyan MFIs.

Further in Kenya, Sheikh et al. (2021) examined how Nairobi MFIs' performance was affected by the composition of the board. Three hundred and fifty-one members of the board from twenty-five MFIs were the respondents. Yamane sampling formula was used to get a sample of one hundred and eighty-seven board members. According to Sheikh et al. (2021), the composition of board had a positive contribution to the performance of MFIs but their low numbers were significantly worrying. Nevertheless, according to CBK (2021) financial report, there were 14 regulated MFIs hence Sheikh et al. (2021) mixed non-regulated MFIs in their data to constitute the target population. Therefore, the current study would assess specifically regulated MFIs.

## **2.7 Summary of Gaps**

The gaps identified after review of studies on capital structure like Bibi et al. (2022) used a qualification criterion where the MFIs included in the study, had over 1.3 million assets worth hence did not include those of less worth. Notably, Parvin et al. (2022) did not assess

other capital structure aspects such as retained earnings. Further, Deyganto (2021) used pecking order theory as part of theoretical framework which has a weakness of being impractical. This is because some firms prefer debt as a source of financing their operations. Further, Orichom and Omeke (2021) did not specify who were the respondents that would answer the questionnaires. Additionally, Odero and Mutswenje (2021) did not assess other financial performance indicators like ROA, gross profit and net profit. Notably, Wangombe and Kibati (2019) did not assess preference share capital as a type of debt capital. Further, the study did not specify the respondents who would answer the questionnaires and as well as any evidence of pre-test study.

The gaps identified after review of studies on product diversification like Mehmood et al. (2019) did not specify which assets were underutilized nor how government regulations affected diversification of products in India's firms. Further, the results related to diversification of products pointed that it instigated a negative relationship with performance of commercial banks. There is therefore need to expand the study and assess whether performance would improve when done on MFIs. This is because both MFIs and commercial banks are regulated by CBK hence there is need to check whether there would a difference or not. Additionally, Maranga et al. (2022) conducted a pre-test in Equity bank which is also a listed bank.

The gaps identified after review of studies on credit risk management like Abu-Rumman et al. (2021) pointed that banks were poorly applying use of Basel I, II and III in borrower assessment when applying for loans. Therefore, since Abu-Rumman et al. (2021) majored on commercial bank, there is need to expand to MFIs to assess the various credit risk management methods guidelines used when assessing borrowers. Notably, Ewool and

Quartey (2021) did not provide further revelations on why risk management practices were moderately applied. Further, the study presented reliability results on Cronbach Coefficients without ever indicating information of pre-test study. Further, Era (2019), did not use questionnaires in collection of data which could have been the best option to inquire on policies in place, credit monitoring methods used and the process followed when pricing loans. Additionally, Leja and Ibrahim (2022) only assessed deposit taking MFIs and did not include non-deposit taking MFIs.

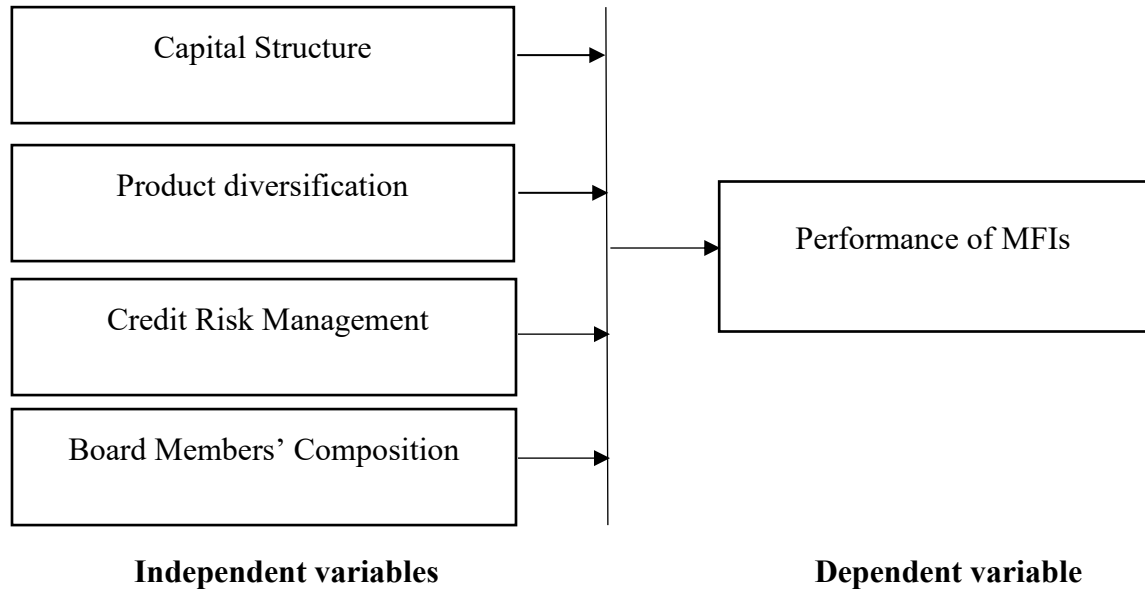
The gaps identified after review of studies on board members' composition like Ngo et al. (2023) did not assess how board member diversity would influence performance. Additionally, Asare et al. (2021) did not assess how other board member's attributes such as financial skills, experience and networks contribute to performance. Further, Sheikh et al. (2021) mixed non-regulated MFIs in their data to constitute the target population. Therefore, the current study would assess specifically regulated MFIs.

## **2.8 Conceptual Framework**

The study' conceptual framework indicated the independent and dependent variables. The independent variables were capital structure, product diversification, credit risk management and board member's composition. The dependent variable was the financial performance as in Figure 2.1.

**Figure 2.1**

***Conceptual framework***



**Capital Structure**

The funding system of an MFI provides a framework through which operations can be easily sustained. When funds are availed from various sources that are amicably balanced, it provides a consistent flow of resources to serve the client's needs (Goodluck & Lebitso, 2019). The common aspect is that it requires an investment of money to create more money that can be used for sustaining the MFI operations as a going concern. Therefore, the management should always ensure that any monetary requirements needed to fund various banking activities, are provided on time and in the appropriate amounts (Mwangudza, et al., 2020). It through this funding system that the MFI is able to issue loans and accept more deposits hence increased performance (Nso, 2018).

### **Product Diversification**

Having diverse accounts and loans products in an MFI, gives clients a chance to improve various ways they could invest and save their wealth (Shahale & Ibrahim, 2022). Therefore, there is a need for the MFIs to provide various avenues that clients could consider when banking. In line with this, the MFI considers that there are different types of clients such as the ones employed, and those with businesses. Additionally, there are clients who have needs such as storing their wealth for speculative purposes while others need financial help to fund their personal lives (Wanjiru & Jagongo, 2022). All these clients have expectations that when they join the MFI, their needs are to be met. Therefore, the MFI considers all these needs and provide accurate products that could satisfy these concerns to remain competitive in the banking industry (Githaiga, 2022).

### **Credit Risk Management**

Managing the money issued out in term of loans is a key function that dictates whether an MFI will exist for long or not. This is because every money loaned out carries a risk of default which could lead to the institution losing revenue (Karanja & Munene, 2019). There is need to actively manage loans in terms proper assessment of borrowers and constant monitoring of the payment installments. It is therefore paramount that MFIs provide a clear policy structure that involve recruiting experienced loan officers, having reliable lending structures as guided by the CBK interest rates (Chemesunde & Gichure, 2020).

### **Board Member's Composition**

Having reliable senior management team is of essence since it makes it easier to formulate financial decisions that are well thought, reliable and can be easily implemented to improve

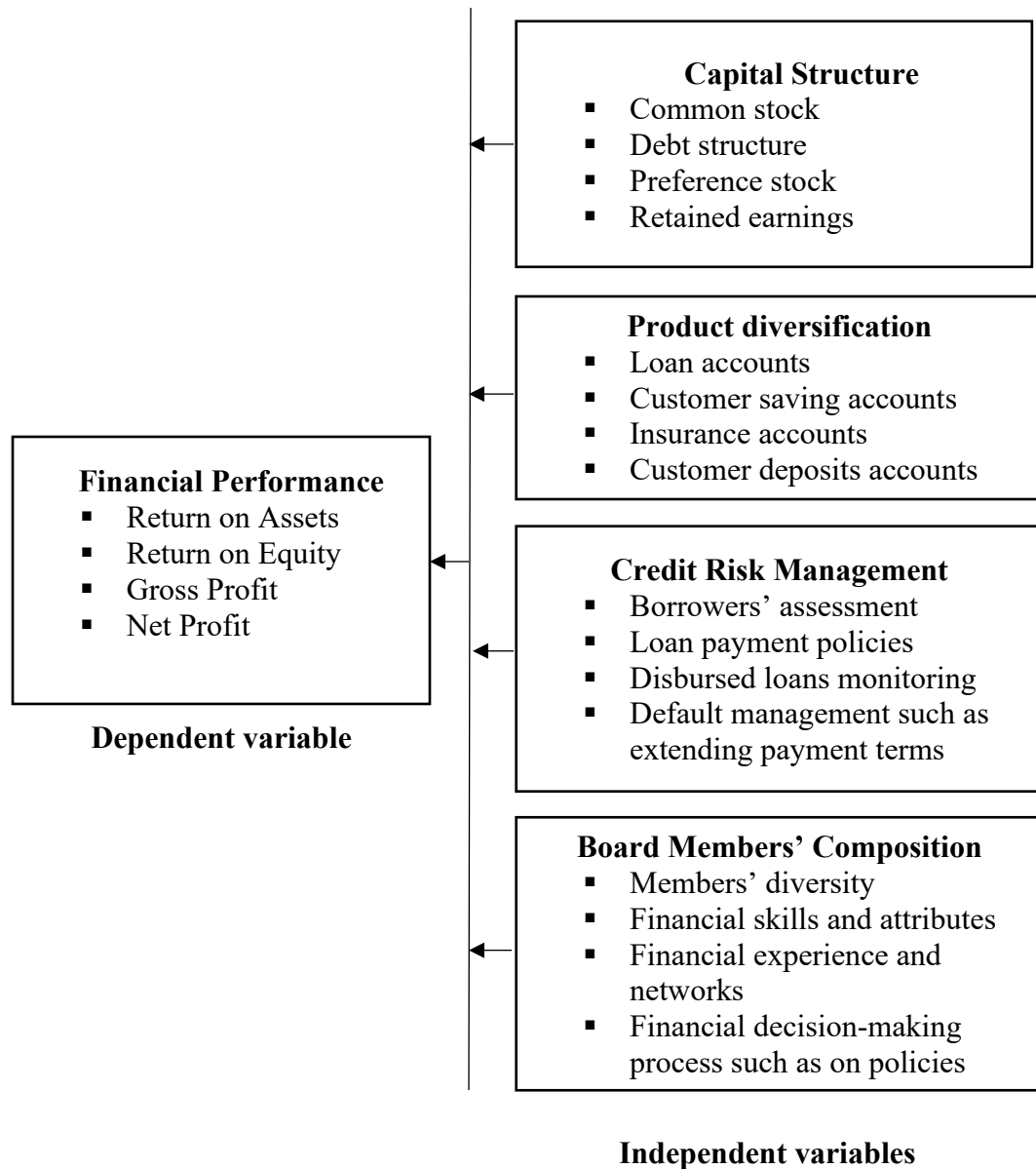
the quality of operations (Muthoni, et al., 2022). It becomes more proficient when the board members are consensus in their decisions especially when they have considered their diversity, financial skills, experience and networks. All these factors enable various decisions affecting operations such as introducing or improving products and processes to facilitate more revenue generation (Njenga & Jagongo, 2019).

## **2.9 Operational Framework**

Operational framework was provided such that the indicators of each variable were described below as in Figure 2.2.

**Figure 2.2**

***Operational Framework***



Financial performance which was the dependent variable, had indicators such as ROA, ROE, gross profit and net profit (CBK, 2021). Capital structure which was the first independent variable, had indicators such as common stock, debt structure, preference

stock, and retained earnings (Bibi et al., 2022). Product diversification which was the second independent variable, had indicators such as loan accounts, customer saving accounts, insurance accounts and customer deposits accounts (Maranga et al., 2022). Credit risk management which was the third independent variable, had indicators such as borrowers' assessment, loan payment policies, disbursed loans monitoring and default management such as extending payment terms (Orichom & Omeke, 2021). Board member's composition which was the fourth independent variable, had indicators such as members' diversity, financial skills and attributes, financial experience and networks and financial decision-making process such as on policies (Sheikh et al., 2021).

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

#### **3.1 Introduction**

The chapter provides research design, location, target population, sampling technique, data collection instruments, pilot study, data collection procedure, data analysis and ethical presentation.

#### **3.2 Research Design**

The study applied descriptive research design during the collection of data (Sileyew, 2019). This is a plan that enables the study to gather facts on specific population which will be the microfinance banks in Nairobi County. In other words, it was a design that enabled the study assess the influence of micro determinants on financial performance without relying on a causal hypothesis. This means that the study collected data without necessarily interfering with their daily schedules such as confining some of them to administer the data collection instruments, as a means of attaining causal effect (Siedlecki, 2020). Additionally, the study used the descriptive research design to explore what was the influence of capital structure on performance; when did product diversification work best as a means of improving performance; where exactly did credit risk management begin and its effect on performance; and how did the composition of the board influence performance.

#### **3.3 Location of the Study**

The study was conducted in Nairobi County since its where all MFIs had their headquarters. Nairobi County hosts a huge population of people who are actively engaged in vibrant economic activities. Therefore, microfinance institutions are able to operate and

sell their products to potentially high number of customers. Apart from that, the regulation by central bank of Kenya have been dictated with tough banking regulations that require high amounts of deposits maintained at all times (CBK, 2021). Further, the MFIs have also encountered stiff competition from other financial institutions like digital lenders, mainstream commercial banks and Saccos (Odero & Mutswenje, 2021). The competition is mainly based on huge amounts and customized loans with lower rates offered dependent on how fast the loan is repaid.

### **3.4 Target Population**

The study's target population was 14 microfinance banks whose respondents were 24 operations managers, 53 tellers, 68 credit officers, 40 customer care officers hence a sum of 185 respondents (CBK, 2021; Kenya Bankers, 2019; Sheikh et al., 2021). The study's choice of dealing with microfinance banks was due to the declining trend in assets whereby they declined by Kshs 3.2 billion in 2022 from Kshs 76 billion in 2021. This was because of reduced debtors (loan applicants) and high inventory expenses in the institutions (CBK, 2021). Further, the operations managers were selected due to their immense knowledge on the board composition and how their decisions affect performance. The tellers were key in providing information on how various products affect performance of the MFIs. The credit and customer service officers were also included in the study so as to gather information related to how capital structure and credit risk management influence performance (Deyganto (2021; Ishmail et al., 2023).

### 3.5 Sampling Procedure and Sample Size

This is the technique that a study uses to identify and choose representatives whose opinion were considered as that of the entire population (Memon et al., 2020). Therefore, in this regard, the study selected the sample size simple random sampling method after determination using Kothari (2004) sampling formular as described below:

$$n = \frac{Z^2 pqN}{e^2 (N-1) + Z^2 pq}$$

Where:

n = Sample size

N= number of operations managers, teller, loan officers and customer service officers

p = Reliability of the population which is 0.5

p + q= 1 e: The margin of error considered for this analysis is 10 per cent. Z  $\alpha/2$ : normal reduced variable with significance z of 0.05 is 1.96

Therefore, in determining the sample size of operations managers

‘N’ of operations managers

$$\begin{aligned} & \frac{(1.96)^2 \times 0.5 \times 0.5 \times 24}{(0.1)^2 (24-1) + [(1.96)^2 \times 0.5 \times 0.5]} \\ &= 19 \text{ managers} \end{aligned}$$

‘N’ of tellers

$$\begin{aligned} & \frac{(1.96)^2 \times 0.5 \times 0.5 \times 53}{(0.1)^2 (53-1) + [(1.96)^2 \times 0.5 \times 0.5]} \\ &= 34 \text{ Tellers} \end{aligned}$$

‘N’ of credit officers

$$\frac{(1.96)^2 \times 0.5 \times 0.5 \times 68}{(0.1)^2 (68-1) + [(1.96)^2 \times 0.5 \times 0.5]}$$

= 40 credit officers

‘N’ of customer service officers

$$\frac{(1.96)^2 \times 0.5 \times 0.5 \times 40}{(0.1)^2 (40-1) + [(1.96)^2 \times 0.5 \times 0.5]}$$

= 28 Customer service officers

Notably the sample size was 19 operations managers, 34 tellers, 40 credit officers, and 28 customer care officers, which was a total of 121 respondents. The sample population is provided in Table 3.1.

**Table 3.1**

***Sampled Population***

No	MFIs	Operation Managers	Tellers	Credit officers	Customer care officers	Total
1.	Caritas	2	3	3	1	9
2.	Branch	1	2	4	3	10
3.	Choice	1	2	2	2	7
4.	Daraja	1	2	2	1	6
5.	Faulu	2	4	4	3	13
6.	Kenya Women	2	3	4	2	11
7.	Maisha	1	2	3	2	8
8.	Muungano	1	3	2	2	8
9.	Rafiki	1	2	3	3	9
10.	LOLC	2	2	2	1	7
11.	SMEP	2	3	4	3	12
12.	Sumac	1	2	3	2	8
13.	U & I	1	2	2	1	6
14.	Salaam	1	2	2	2	7
	<b>Total</b>	<b>19</b>	<b>34</b>	<b>40</b>	<b>28</b>	<b>121</b>

### **3.6 Data Collection Instruments**

The study collected quantitative data using self-administered questionnaires which are closed-ended in nature (appendix II). They had an Ordinal Likert scale whereby 1 was strongly disagreed, 2 was disagreed, 3 was neutral, 4 was agreed and 5 strongly agreed. The questionnaires were answered by all the respondents and it contained several sections that are related to the objectives of the study (Busetto et al. 2020). The first section asked questions related to the background information of the respondents such as their job description and work experience. Section 2-5 asked questions that relate to capital structure, product diversification, credit risk management, board composition and performance. The questions were five in number based on the indicators and the gaps generated after literature review in chapter two of the study.

Further, the study also used secondary data collection form to gather information on financial performance metrics such as ROA, ROE, gross profit and net profit (appendix III). This information was gotten from audited financial reports such as income statements and balance sheets. The secondary data was collected for a 5-year period beginning from 2018 to 2022. This provided an articulate picture of how MFIs have been performing and where exactly was the performance lagging.

### **3.7 Pre-test Study**

The study pre-tested questionnaires in two commercial banks located in Nairobi County. These were Cooperative bank and I&M bank which are public and private respectively. The banks were selected since they are also within the same county as the main study's hence the issues concerning liquidity, customer numbers and declining assets are also engulfing them. A study by Mugenda and Mugenda (2003) suggested that for a pre-test

study, the study should use ten percent from the sample size and in this regards, 2 operations managers, 3 tellers, 4 loan officers and 3 customer care staff.

### **3.7.1 Reliability**

The study ensured that the questionnaires had the ability to be re-used through examining the Cronbach Alpha coefficients. That is, once the pre-test questionnaires are returned, the study assessed the responses and place them within the range of Cronbach Alpha to establish whether the pre-test respondents experienced any ambiguity in the questions asked. According to Taber (2018), Cronbach Alpha has a range from 0-7 whereby reliability in research instruments should be determined once the report generated falls in between 0.7 to 1 and anything less than that reflects unreliability. In the case where the questionnaires proved unreliable, the study either restructured the questionnaires or simplify the language used depending on the overall range.

### **3.7.2 Validity**

This is defined as the capacity of an instrument to quantify what it should. Notably, the study assessed criterion, construct and face types of validity (Surusu & Maslakci, 2020). Criterion validity was assessed when the findings of the study on each variable was compared with previous findings (Surusu & Maslakci, 2020). This provided a clear aspect on how the current study contributed new knowledge to the body of research. Construct validity was assessed through asking questions that were relevant to each variable under scrutiny (Surusu & Maslakci, 2020). This enabled the study to avoid going off-topic as a measure of maintaining the integrity of the findings. Face validity was assessed through examining ways through which capital structure, product diversification, credit risk

management, composition of board members and performance address the influence of micro determinants on financial performance of MFIs.

### **3.8 Data Collection Procedure**

The analyst initially obtained the approval reports, for example, presentation letter from KeMU and NACOSTI license. Thereafter, data collection commenced in such a way that the researcher did not employ any research assistants. This is because, the researcher required to have in-depth knowledge on the process of data collection and as well as identify various challenges experienced. During the information assortment day, the scientist visited all the 14 MFIs and demand approving supervisor to be permitted to gather information from the respondents. Once the process was approved, the researcher with the help of the manager identified the respondents as sampled in the study. They were issued with the consent letter hence append whether they agree or disagree in participating in the study (appendix I). Once they agreed, the researcher issued the questionnaire and awaited them to fill in every question. Incase on ambiguous questions, the researcher was present to clarify the statements to them. The respondents that did not have time to complete the questionnaire were given a period of two days to complete and after which the researcher came and picked the filled in questionnaires. Thereafter, the researcher stored the filled in questionnaires as they waited for the next process of data analysis.

In regards to secondary data, the researcher further inquired from the authorizing manager on how balance sheets and income statements could be accessed. If they are available in the headquarter, the researcher was issued and derived the required financial performance metrics such as ROA, ROE, gross profit and net profit. However, if the reports could be gotten from the MFI's website, the researcher used an internet enabled computer to access

the website and proceed to the report portal whereby the reports were downloaded. This enabled the researcher get the financial performance metrics required.

### **3.9 Data Analysis and Presentation**

The study sort and cleaned the data to ensure that there were no incomplete questionnaires. Thereafter, quantitative data was analyzed using SPSS software version 25 to generate descriptive and inferential statistics. The various descriptive analysis were frequencies, percentage and mean, while linear and multiple regression analysis was done as part of inferential statistics analysis. Under linear regression analysis, the study examined model summary and ANOVA of each independent variable. The multiple regression was used to ascertain the regression coefficient to test the model of the study. The study's model was as follows:

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

Where:

Y = Financial Performance

$\beta_i$  = Coefficients to be estimated

C = Constant

X<sub>1</sub> = Capital Structure

X<sub>2</sub> = Product diversification

X<sub>3</sub> = Credit Risk Management

X<sub>4</sub> = Board Composition

The results were presented using tables and explanation befitting all the criterion and face validity. Additionally, the study did also test various diagnostic tests such as multicollinearity, heteroskedasticity, normality and linearity tests.

### **3.10 Ethical Considerations**

Through an introduction letter, the study made known to the respondents of what it was all about. In addition, KeMU provided letters of recommendation to confirm background of the researcher and the intention of the study being for academic purposes. The study applied to the regulatory authority NACOSTI for permission to collect data from MFIs. The study's researcher respected the opinion of the respondents and made known that this survey was voluntary (appendix I). Since the questionnaire were anonymous, the respondent's identity was kept a secret. Further, the fundamental information gathered was handled with the essential secrecy and won't be personalized.

## CHAPTER FOUR

### RESULTS AND DISCUSSION

#### 4.1 Introduction

The chapter covers the response rate, reliability tests, diagnostic test, descriptive results, and linear regression analysis such as model summary and ANOVA of each independent variable. Thereafter, the study presents the multiple regression analysis results which entails the regression weights to answer the study's model.

#### 4.2. Response Rate

The study had sampled 19 operations managers, 34 tellers, 40 credit officers, and 28 customer care officers, which is a total of 121 respondents. They were issued with questionnaires and Table 4.1 gives the response rate.

**Table 4.1**

#### *Response Rate*

<b>Respondents</b>	<b>Sampled</b>	<b>Responded</b>	<b>Percentage</b>
Operations managers	19	15	
Tellers	34	27	
Credit officers	40	35	
Customer care officers	28	21	
<b>Total</b>	<b>121</b>	<b>98</b>	<b>81%</b>

Table 4.1 discloses that 98 out of the sampled 121 respondents returned fully filled questionnaires which was 81%. This meant that the respondents participated in a high

number due to the contribution the study had towards the banking profession. Notably, Gustavson et al. (2019) pointed that when the response rate is at 70% it indicated that there was high response hence the study had excellent feedback.

### 4.3 Reliability Test Results

The review led a pre-test investigation of the surveys in two commercial banks located in Nairobi County. These were Cooperative bank and I&M bank and from which 2 operations managers, 3 tellers, 4 loan officers and 3 customer care staff, answered the rep-test questionnaires as in Table 4.2.

**Table 4.2**

#### *Reliability Test Results*

<b>Variable</b>	<b>Cronbach Alpha</b>	<b>No of Item</b>
Capital structure	0.922	12
Product diversification	0.893	12
Credit risk management	0.814	12
Board members' composition	0.948	12
Financial performance	0.870	12

Table 4.2 discloses that the Cronbach Alpha value for capital structure was 0.922, product diversification was 0.893, credit risk management was 0.814, board members' composition was 0.948 and financial performance was 0.870. According to Taber (2018), when the Cronbach Alpha's value ranges from 0.7 to 1, it indicates reliability and anything less than 0.7 reflects unreliability. Based on this insight, the results proved that the data collection

instruments were reliable hence could be re-used over and over to give an accurate and similar results.

#### 4.4 Demographic Information Results

The personal information asked in the questionnaires included their working position, work experience and ranges of their monthly income. The results are in Table 4.3 to 4.5.

**Table 4.3**

##### *Working Position*

<b>Gender</b>	<b>Frequency</b>	<b>Percentage</b>	<b>Cumulative Percentage</b>
Operations managers	15	15%	15%
Tellers	27	28%	43%
Credit officers	35	36%	79%
Customer care officers	21	21%	100%
<b>Total</b>	<b>98</b>	<b>100</b>	

Table 4.3 discloses that the ninety-eight respondents comprised of 15 operations managers, 27 tellers, 35 credit officers, and 21 customer care officers. Therefore, based on the results, it is paramount to indicate that in every category of respondents, all the levels of management were represented, thereby giving an accurate account of how each of the micro determinants such as capital structure, product diversification, credit risk management, and board members' composition improved performance.

Further, the study inquired on the work experience of the study's participants as in Table 4.4.

**Table 4.4**

***Work Experience at the MFI***

<b>Working Experience</b>	<b>Frequency</b>	<b>Percentage</b>
Over 10 years	19	19%
6-10 years	28	29%
1-5 years	34	35%
Less than 1 year	17	17%
<b>Total</b>	<b>98</b>	<b>100</b>

Table 4.4 discloses that it was evident that 34(35%) staff had worked in the MFIs within 1-5 years and also 28(29%) had worked for 6-10 years. However, 17(17%) had worked in less than one year. Therefore, the results indicated that most MFIs had taken enough time to employ experienced staff who would work in the institutions for a long-time duration of time. Therefore, these staff over time were actively involved in diversifying products, managing credit risk and contributing their skills and competencies towards improving the capital structure. In support with the findings, Ademola et al. (2022) established that most Nigerian MFIs were doing well in their performances due to having reliable staff that would provide clear corporate governance in terms of contributing their skills and knowledge on the same.

Additionally, the study inquired on the monthly income of the study's participants as in Table 4.5.

**Table 4.5**

***Monthly Income***

<b>Working Experience</b>	<b>Frequency</b>	<b>Percentage</b>
Above Kshs 100,000	18	18%
Kshs 50,001-Kshs 100,000	21	21%
Kshs 10,001-Kshs 50,000	52	53%
Less than Kshs 10,000	7	8%
<b>Total</b>	<b>98</b>	<b>100</b>

Table 4.5 discloses that 52(53%) participants earned a monthly income of Kshs 10,001-Kshs 50,000. Additionally, 21(21%) earned a monthly income of Kshs 50,001-Kshs 100,000. Nevertheless, 7(8%) respondents were paid a monthly pay of less than Kshs 10,000 especially those who were still working on probation of short-term contracts. This is an indication that the monthly income paid to various staff by the MFIs was to soe extend decent and highly pegged on their job description and experience. However, it was established that MFIs paid their new staff still in probation or employed under short-term contract very low. UNECA (2020) also complained that African private institutions were paying their staff low wages in comparison to other staff in Global index. As a result, it demotivated the staff towards delivering their mandates in a more efficient manner.

#### **4.5 Diagnostic Tests**

The diagnostic tests were steered to ascertain the viability of the data collected towards providing accurate analysis results as provided in sections below.

#### 4.5.1 Normality Test

Normality test was conducted to ascertain whether the collected data was suitable and no questionnaires had responses that were not evenly distributed. That is, when the responses to particular questions were drawn on a normality curve, they were symmetrical and not inclined to either of the side of the curve. According to Mishra (2019), for a data set to articulately show that its normal, the significance value have to be more than 0.05. The results are in Table 4.6.

**Table 4.6**

#### *Normality Test*

		<b>Capital Structure</b>	<b>Product Diversific ation</b>	<b>Credit Risk Managem ent</b>	<b>Board Members Compositi on</b>	<b>Financial Performa nce</b>
N		98	98	98	98	98
Normal	Mean	22.6837	21.6939	13.3163	21.7143	20.6224
Parameters <sup>a</sup>	Std.					
, <sup>b</sup>	Deviation	1.89735	2.77473	3.72674	2.56061	2.56670
Most	Absolute	.237	.228	.097	.238	.194
Extreme	Positive	.189	.211	.097	.114	.122
Differences	Negative	-.237	-.228	-.077	-.238	-.194
Kolmogorov-Smirnov Z		.345	.255	.956	.359	.921
Asymp. Sig. (2-tailed)		.092	.061	.320	.104	.294

a. Test distribution is Normal.

b. Calculated from data.

Table 4.6 discloses that capital structure had a value of 0.092, product diversification had 0.061, credit risk management had 0.320, board membership composition had 0.104, and financial performance had 0.294. Therefore, since all the significance values were above

0.05, it pointed that the data was normal and did not contain anomalous responses that are inclined to any side.

#### 4.5.2 Autocorrelation Test

Autocorrelation test was examined to assess how the interactions capital structure, product diversification, credit risk management and board members composition remain stable and were not influenced by other variable's characteristics. The study used Durbin-Watson to assess how they were correlated to each other and according to Turner (2019), when the range was 0-2, it indicated positive correlation. Further, when at the Durbin Watson value was 2, it indicated no correlation. However, when the range was 2-4, it indicated negative correlation. The results are in Table 4.7.

**Table 4.7**

#### *Autocorrelation Test*

<b>Model</b>	<b>R</b>	<b>R Square</b>	<b>Adjusted R Square</b>	<b>Std. Error of the Estimate</b>	<b>Durbin-Watson</b>
1	.861 <sup>a</sup>	.741	.645	2.50828	1.386

a. Predictors: (Constant), Board Members Composition, Credit Risk Management, Product Diversification, Capital Structure

b. Dependent Variable: Financial Performance

Table 4.7 discloses that the Durbin Watson value was 1.386 hence being within the range of 0-2, it signified that the variables had a positive correlation towards financial performance. This therefore, pointed that when combined, all the micro determinants considered in this study, had a high statistical correlation and had the potential of improving performance.

### 4.5.3 Multicollinearity Test

The study examined whether the data set had a multicollinearity problem. That is, whether when combined, independent variables were easily changed by other variables. According to Daoud (2019) for a data set to be free from multicollinearity, the tolerance level should be above 0.2 and VIF below 5. The results are in Table 4.8.

**Table 4.8**

#### *Multicollinearity Test*

Model		Collinearity Statistics	
		Tolerance	VIF
1	(Constant)		
	Capital Structure	.627	2.013
	Product Diversification	.301	3.318
	Credit Risk Management	.942	1.062
	Board Members' Composition	.412	3.706

Table 4.8, discloses that the capital structure's tolerance level was 0.627 at a VIF of 2.013, product diversification's tolerance level was 0.301 at a VIF of 3.318, credit risk management's tolerance level was 0.942 at a VIF of 1.062, and board members' composition tolerance level was 0.412 at a VIF of 3.706. Therefore, since the tolerance level was above 0.2 and VIF below 5, all the variables were free of multicollinearity problem. That is, the independent variables were not easily swayed by other variables such as the financial performance but its them that influenced the increment or decrement of performance.

#### 4.5.4 Linearity Test

Linearity test was conducted to examine whether the independent variables were in tandem and had an existing relationship with the dependent variables. The results are in Table 4.9.

**Table 4.9**

#### *Linearity Test*

			Sum of Squares	df	Mean Square	F	Sig.
Financial Performance *	Between Groups	(Combined)	53.629	9	5.959	.896	.533
		Linearity	14.968	1	14.968	2.250	.137
		Deviation from Linearity	38.661	8	4.833	.726	.668
	Within Groups		585.401	89	6.652		
	Total		639.031	98			
Capital Structure	Between Groups	(Combined)	119.137	8	14.892	2.549	.215
		Linearity	15.814	1	15.814	2.707	.103
		Deviation from Linearity	103.323	7	14.760	2.527	.120
	Within Groups		519.894	90	5.842		
	Total		639.031	98			
Product Diversification	Between Groups	(Combined)	91.736	13	7.057	1.083	.385
		Linearity	7.830	1	7.830	1.202	.276
		Deviation from Linearity	83.906	12	6.992	1.073	.393
	Within Groups		547.294	85	6.515		
	Total		639.031	98			
Credit Risk Management	Between Groups	(Combined)	84.110	10	8.411	1.319	.233
		Linearity	1.098	1	1.098	.172	.679
		Deviation from Linearity	83.012	9	9.224	1.446	.181
	Within Groups		554.920	88	6.378		
	Total		639.031	98			
Board Members Composition	Between Groups	(Combined)	84.110	10	8.411	1.319	.233
		Linearity	1.098	1	1.098	.172	.679
		Deviation from Linearity	83.012	9	9.224	1.446	.181
	Within Groups		554.920	88	6.378		
	Total		639.031	98			

Table 4.9 discloses that the significance value for capital structure was 0.668, product diversification was 0.120, credit risk management was 0.393 and board members' composition was 0.181. Therefore, since all the values were above 0.05 and according to Epshtein, (2019), indicated the relationship between the tested micro determinants and financial performance was linear.

#### **4.6 Descriptive Results of Financial Performance**

The questionnaire had questions relating to financial performance which was assessed through analysis of secondary data and questionnaire. The results on secondary data analyzed are presented on Table 4.10.

**Table 4.10**

##### ***Secondary Data***

<b>Variable</b>	<b>N</b>	<b>Mean</b>
ROA	14	2.4
ROE	14	3.1
Gross Profit	14	3.5
Net Profit	14	2.9

Table 4.10 discloses that the gross profit had the highest mean of 3.5, followed by ROE which had a mean of 3.1. This indicated that shareholders wealth grew since it was the responsibility of the bank staff to expand their owners' wealth. However, the ROA and net profit had the lowest mean of 2.4 and 2.9 respectively which is in agreement with CBK (2021) that the value of assets in Kenyan MFI had reduced from Kshs 76 billion to 72.8

billion in 2021 and 2022 respectively. This meant that the banks were struggling to remain liquid in terms of the assets and profitability.

Further on, questionnaires had an Ordinal Likert scale whereby 1 was strongly disagreed, 2 was disagreed, 3 was neutral, 4 was agreed and 5 strongly agreed as in Table 4.11.

**Table 4.11**

*Descriptive Statistics of Financial Performance*

Statements N=98	1	2	3	4	5	Mean
The use of various capital structure mix has increased ROE	2(2%)	1(1%)	0(0%)	8(8%)	87(89%)	4.81
Product diversification has increased the returns made on assets	0(0%)	13(13%)	0(0%)	30(31%)	55(56%)	4.30
The gross income has expanded since there are less losses experienced from defaulted loans as a result of quality credit risk management	6(6%)	42(43%)	0(0%)	50(51%)	0(0%)	2.96
Quality decisions made on reduction of operational expenses have resulted to increased net income	2(2%)	1(1%)	0(0%)	8(8%)	87(89%)	4.81
There is an influence of micro-determinants on financial performance	0(0%)	14(14%)	32 (33%)	16(16%)	36(37%)	3.76

Table 4.11 discloses that 87(89%) strongly agreed and 8(8%) agreed (mean of 4.81) that the use of various capital structure mix had increased return on equity and that the quality

decisions made on reduction of operational expenses by the board members resulted to increased net income. Notably, the results reveal that quality capital structure enabled the bank incorporate visionary board managers who sourced for investors to inject capital to the MFIs through share capital and also through increased deposits and investments. Therefore, this enabled the MFIs to adequately fund their operations and at the same becoming mindful of their expenditures since every invested amount required results. That is, for every funding of an activity, required to show the income generated and failure to which disciplinary actions followed.

Nevertheless, 6(6%) strongly disagreed and 42(43%) disagreed (mean of 2.96) that the gross income had expanded since there were less losses experienced from defaulted loans as a result of quality credit risk management structure. This is a clear indication that the problem about default of loans at the MFIs was not yet fully sorted. This is whereby, money was provided to clients and thus lacked clear credit management structure resulting to poor monitoring of loans. Therefore, when the laxity of constantly reminding the borrowers to make payments was present, most of the borrowers defaulted. Orichom and Omeke (2021) also complained that when there was no clear system of how thousands of borrowers could be tracked (in terms of employing adequate staff, ICT and enforcement measures), almost half of the loans issued got defaulted in most Ugandan MFIs.

#### **4.7 Descriptive Results of Capital Structure**

The questionnaire had five questions relating to capital structure and its results are in Table 4.12.

**Table 4.12*****Descriptive Statistics of Capital Structure***

<b>Statements N=98</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>	<b>Mean</b>
This MFI offers common stock as part of raising its share capital	0(0%)	0(0%)	0(0%)	9(9%)	89(91%)	4.91
There are clear policies that guide on which type of debt that the MFI hold at any particular financial year	0(0%)	7(7%)	1(1%)	12(12%)	78(80%)	4.64
Preference stock subscribers are highly sorted since they invest in huge amounts	1(1%)	0(0%)	0(0%)	6(6%)	91(93%)	4.90
Management allows a portion of MFIs retained earnings to be used in operations	19(19%)	30(31%)	0(0%)	29(30%)	20(20%)	2.92
The MFI has invested in modern ICT system to monitor and evaluate the capital structure levels, as a measure of maintaining the minimum required threshold at all times	0(0%)	6(6%)	0(0%)	49(50%)	43(44%)	4.32

Table 4.11 discloses that 89(91%) strongly agreed and 9(9%) agreed (mean of 4.91) that their MFIs offered common stock as part of raising the share capital. Further, 91(93%)

strongly agreed and 6(6%) agreed (mean of 4.90) that preference stock subscribers were highly sorted since they invested in huge amounts. Nevertheless, 19 (19%) strongly disagreed and 30(31%) disagreed (mean of 2.92) that the management allowed a portion of retained earnings to be used in operations of the MFI as a measure of reducing the cost of borrowing.

Notably, the management of MFIs were very active in ensuring that their institution's share capital grew over time. This was due to incorporation of frequent floating of both common stock and preference shares. Each of the option had its advantages and disadvantages customized in terms of decision making, payment system and assurance of protection of wealth. However, the management was cautious enough in re-investing the profits back to the operation of MFI when there were options of considering debt. This was caused by the fact that the shareholders demanded consistent results on dividends payouts hence becoming hard to maintain reserves at the CBK and also re-invest in the operations. Comparatively, Bibi et al. (2022) shared similar sentiments whereby they argued that the profit-sharing formula to shareholders was a great concern to many MFIs and no wonder they were not improving on profitability. This was whereby most of the MFIs made significant profits at the close of each financial year but the same was not reflected in terms of increased their reserve kitty.

#### **4.8 Model Summary of Capital Structure**

A model summary analysis was conducted to ascertain how strong was the capital structure variable towards improving performance as presented in Table 4.13.

**Table 4.13*****Model Summary of Capital Structure***

<b>Model</b>	<b>R</b>	<b>R Square</b>	<b>Adjusted R Square</b>	<b>Std. Error of the Estimate</b>	<b>Durbin-Watson</b>
1	.729 <sup>a</sup>	.531	.520	2.54964	1.428

a. Predictors: (Constant), Capital Structure

b. Dependent Variable: Financial Performance

Table 4.13 discloses that R was 0.729 and R-square was .531 at a Durbin-Watson value of 1.428. Thereby, it was evident that capital structure had a 53.1% influence on financial performance which was positively correlated. The other 46.9% constituted of other elements not considered in the study. Therefore, capital structure was an important element when considering how performance can be improved in an MFI. In support, Wangombe and Kibati (2019) also found out that its dictated 55.8% influence on performance.

**4.9 ANOVA of Capital Structure**

ANOVA was used to test the hypothesis so as to ascertain whether the null hypothesis would be accepted or rejected depending on the significance value as in Table 4.14.

**Table 4.14*****ANOVA of Capital Structure***

<b>Model</b>		<b>Sum of Squares</b>	<b>df</b>	<b>Mean Square</b>	<b>F</b>	<b>Sig.</b>
1	Regression	14.968	1	14.968	2.303	.002 <sup>b</sup>
	Residual	624.063	97	6.501		
	Total	639.031	98			

a. Dependent Variable: Financial Performance

b. Predictors: (Constant), Capital Structure

Table 4.14 discloses that the significance coefficient was 0.002 hence less than 0.05. The results therefore enabled the study reject the null hypothesis that capital structure had a positive influence on financial performance. Similar studies such as Parvin et al. (2022) and Deyganto (2021) also found out a positive influence but other studies such as Orichom and Omeke (2021) found a negative influence. However, Orichom and Omeke (2021) considered only equity and debt components of capital structure, while the current study included retained earnings.

#### **4.10 Descriptive Results of Product Diversification**

The questionnaire had five questions relating to product diversification and its results are in Table 4.15.

**Table 4.15*****Descriptive Statistics of Product Diversification***

<b>Statements N=98</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>	<b>Mean</b>
There are efforts from the management to allow the existence of different types of loan products	2(2%)	0(0%)	0(0%)	9(9%)	87(89%)	4.83
Customers are encouraged to increase the amounts in the savings accounts through group savings	19(19%)	16(16%)	5(5%)	30(31%)	28(29%)	3.47
The MFI has employed qualified staff that manage various insurance accounts	0(0%)	11(11%)	0(0%)	49(50%)	38(39%)	4.16
There are direct benefits associated to deposit accounts that clients hold in the MFI	20(20%)	26(27%)	2(2%)	27(28%)	23(23%)	3.32
The staff are always encouraged to offer suggestions to the management on how products could be improved	21(21%)	19(20%)	12 (12%)	28(29%)	18(18%)	2.92

Table 4.15 discloses that 87(89%) strongly agreed and 9(9%) agreed (mean of 4.83) that there were efforts from the management to allow the existence of different types of loan products with various requirements. Further, 38(39%) strongly agreed and 49(50%) agreed (mean of 4.16) that the MFI had employed qualified staff that manage various insurance accounts whereby they were able to release funds to clients when the unfortunate events

happened. Nevertheless, 21(21%) strongly disagreed and 19(20%) disagreed (mean of 2.92) that the staff were always encouraged to offer suggestions to the management on how products could be improved further to incorporate the needs of each customer.

The results indicated that the MFIs had ensured that different products were present at all times to capture the needs of every clientele. These products not only related to banking but also insurance products to capitalize on revenue generation. That notwithstanding, there was excessive bureaucracy whereby the rolling-out of products was supposed to come from the senior management and no other input was required to be included such as from the staff. According to Maranga et al. (2022), the excessive bureaucracy could be as a result of a raft of issues relating to breakdown of communication between the management and staff.

#### 4.11 Model Summary of Product Diversification

A model summary analysis was conducted to ascertain how strong was the product diversification variable towards improving performance as presented in Table 4.16.

**Table 4.16**

##### *Model Summary of Product Diversification*

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.746 <sup>a</sup>	.557	.545	2.54791	1.442

a. Predictors: (Constant), Product Diversification

b. Dependent Variable: Financial Performance

Table 4.16 discloses that R was 0.746 and R-square was .557 at a Durbin-Watson value of 1.442. Thereby, it was evident that product diversification had a 44.3% influence on

financial performance which was positively correlated. The other 44.3% constituted of other elements not considered in the study. A past author such as Maranga et al. (2022) established a 76.7% influence on performance. This was through considering bancassurance, financial securities, real estate and trade finance product. However, loan accounts, customer saving accounts and deposits accounts were not included hence no wonder the results of the current study have a 55.7% influence.

#### 4.12 ANOVA of Product Diversification

ANOVA was used to test the hypothesis so as to ascertain whether the null hypothesis would be accepted or rejected depending on the significance value as shown in Table 4.17.

**Table 4.17**

#### *ANOVA of Product Diversification*

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	15.814	1	15.814	2.436	.001 <sup>b</sup>
	Residual	623.217	97	6.492		
	Total	639.031	98			

a. Dependent Variable: Financial Performance

b. Predictors: (Constant), Product Diversification

Table 4.17 discloses that the significance coefficient was 0.001 hence less than 0.05. The results therefore enabled the study reject the null hypothesis that product diversification had a positive influence on financial performance. Notably, Ndungu (2019) found out a negative correlation while Maranga et al. (2022) found a positive influence on performance.

### 4.13 Descriptive Results of Credit Risk Management

The questionnaire had five questions relating to credit risk management and its results are presented in Table 4.18.

**Table 4.18**

#### *Descriptive Statistics of Credit Risk Management*

Statements N=98	1	2	3	4	5	Mean
There is a catalogue such as use of Basel I, II and III guidelines that provides the requirements needed for any loan application	12(12%)	20(20%)	0(0%)	42(43%)	24(25%)	3.73
Clients are always informed through writing and direct communication on how, when and the amounts they are supposed to repay their loans	9(9%)	4(4%)	1(1%)	44(45%)	40(41%)	4.94
The MFI has invested in ICT systems that enable the credit officers manage their loan portfolios adequately to monitor disbursed loans	41(42%)	18(19%)	15 (15%)	9(9%)	15(15%)	2.38
The credit officers are highly trained on various techniques of ensuring that default rate is reduced	41(42%)	19(20%)	11 (11%)	17(17%)	10(10%)	2.35
There are more than two credit officers required to approve a loan application	29(30%)	4(4%)	3(3%)	42(43%)	20(20%)	3.92

Table 4.15 discloses that 40(41%) strongly agreed and 44(45%) agreed (mean of 4.94) that clients were always informed through writing and direct communication on how, when and the amounts they were supposed to repay on their loans. Nevertheless, 41(42%) strongly disagreed and 19(20%) disagreed (mean of 2.35) that the credit officers were highly trained on various techniques of ensuring that default rate was reduced such as extending the payment terms when need be. Notably, 41(42%) strongly disagreed and 18(19%) disagreed (mean of 2.38) that the MFI had invested in ICT systems that enabled the credit officers manage their loan portfolios adequately to monitor disbursed loans.

This means that the MFIs had put measures to ensure that clients were informed on when to pay and what to pay. This acted as a reminder to clients to honor their part of debt obligation. Nevertheless, the default menace was still a challenge due to low training and sensitization of staff on how to go about different situations of uncooperative borrowers. The main option used was enforcement through auction even when it was unnecessary. According to Leja and Ibrahim (2022), there was a challenge when a borrower made payments and that was not reflected on the MFI's system due to poor ICT infrastructure and failure. This resulted to disagreements on how much is owed thereby confusing both the MFIs' staff and the borrower.

#### **4.14 Model Summary of Credit Risk Management**

A model summary analysis was conducted to ascertain how strong was the credit risk management variable towards improving performance as presented in Table 4.19.

**Table 4.19**

***Model Summary of Credit Risk Management***

<b>Model</b>	<b>R</b>	<b>R Square</b>	<b>Adjusted R Square</b>	<b>Std. Error of the Estimate</b>	<b>Durbin-Watson</b>
1	.651 <sup>a</sup>	.424	.402	2.56418	1.834

a. Predictors: (Constant), Credit Risk Management

b. Dependent Variable: Financial Performance

Table 4.19 discloses that R was 0.651 and R-square was .424 at a Durbin-Watson value of 1.834. Thereby, it was evident that credit risk management had a 42.4% influence on financial performance which was positively correlated. The other 57.6% constituted of other elements not considered in the study. On the one hand, studies such as Leja and Ibrahim (2022) found out that it had 46.1% influence while on the other hand, Ewool and Quartey (2021) found 61.1% influence. The two studies assessed different factors of credit management while the current study assessed borrowers' assessment, loan payment policies, disbursed loans monitoring and default management.

**4.15 ANOVA of Credit Risk Management**

ANOVA was used to test the hypothesis so as to ascertain whether the null hypothesis would be accepted or rejected depending on the significance value as shown in Table 4.20.

**Table 4.20**

***ANOVA of Credit Risk Management***

<b>Model</b>		<b>Sum of Squares</b>	<b>df</b>	<b>Mean Square</b>	<b>F</b>	<b>Sig.</b>
1	Regression	7.830	1	7.830	1.191	.008 <sup>b</sup>
	Residual	631.201	97	6.575		
	Total	639.031	98			

a. Dependent Variable: Financial Performance

b. Predictors: (Constant), Credit Risk Management

Table 4.20 discloses that the significance coefficient was 0.008 hence less than 0.05. The results therefore enabled the study reject the null hypothesis that credit risk management had a positive influence on financial performance. Past studies such as Abu-Rumman et al. (2021) established a positive influence on performance.

**4.16 Descriptive Results of Board Members' Composition**

The questionnaire had five questions relating to board members' composition and its results are in Table 4.21.

**Table 4.21*****Descriptive Statistics of Board Member's Composition***

<b>Statements N=98</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>	<b>Mean</b>
Board members are allowed to contribute their own independent opinion to increase diversity in decisions	3(3%)	11(11%)	0(0%)	17(17%)	67(69%)	4.37
The current members of the board are highly skilled and contained positive attributes that are utilized in steering the MFI's policy structure	0(0%)	7(7%)	1(1%)	12(12%)	78(80%)	4.64
The MFI has benefitted a lot from the experience and network of the board members through increased customer numbers	1(1%)	11(11%)	0(0%)	15(15%)	71(73%)	4.47
The decision-making process among board members is swift since they are objective in their contribution to policies	49(50%)	19(19%)	0(0%)	30(31%)	0(0%)	2.62
The MFI's management is keen in ensuring that they appoint board members of high integrity	0(0%)	6(6%)	0(0%)	49(50%)	43(44%)	4.32

Table 4.21 discloses that 78(80%) strongly agreed and 12(12%) agreed (mean of 4.64) that the current members of the board were highly skilled and contained positive attribute that

was utilized in steering the MFI's policy structure. Additionally, 78(80%) strongly agreed and 12(12%) agreed (mean of 4.47) that the MFIs had benefitted a lot from the experience and network of the board members through increased customer numbers who deposited and saved their money with the institution. Nevertheless, 49(50%) strongly disagreed and 19(19%) disagreed (mean of 2.62) that the decision-making process among board members was swift since they were objective in their contribution to policies.

Therefore, it is paramount that the contribution of the board members was key towards boosting performance. This could be in terms of skills, experience and networks which would in one way or another improve deposits and other investments in the MFIs financial system. That notwithstanding, the process used to make decisions was relatively lower than what was expected. That is, they took more time to deliberate on various aspects such as policy changes, implementation of products, and staff management systems among other operational issues. On the one end, it resulted to well thought ideas and solution but on the other end their application could be surpassed by time hence ineffective to the dynamic financial systems. Accordingly, Sheikh et al. (2021) also weighed in that lack of optimal decision making was affecting the timelines on the delivery of solutions to the operations in Nairobi MFIs

#### **4.17 Model Summary of Board Members' Composition**

A model summary analysis was conducted to ascertain how strong was the board members' composition variable towards improving performance as presented in Table 4.22.

**Table 4.22**

***Model Summary of Board Members' Composition***

<b>Model</b>	<b>R</b>	<b>R Square</b>	<b>Adjusted R Square</b>	<b>Std. Error of the Estimate</b>	<b>Durbin-Watson</b>
1	.783 <sup>a</sup>	.613	.609	2.57781	1.408

a. Predictors: (Constant), Board Members' Composition

b. Dependent Variable: Financial Performance

Table 4.22 discloses that R was 0.783 and R-square was .613 at a Durbin-Watson value of 1.408. Thereby, it was evident that board members' composition had a 61.3% influence on financial performance which was positively correlated. The other 38.7% constituted of other elements not considered in the study. Notably, Sheikh et al. (2021) found out that board composition had a low influence of 37.5% on performance.

**4.18 ANOVA of Board Members' Composition**

ANOVA was used to test the hypothesis so as to ascertain whether the null hypothesis be accepted or rejected depending on the significance value as shown in Table 4.23.

**Table 4.23*****ANOVA of Board Members' Composition***

<b>Model</b>		<b>Sum of Squares</b>	<b>Df</b>	<b>Mean Square</b>	<b>F</b>	<b>Sig.</b>
1	Regression	1.098	1	1.098	.165	.005 <sup>b</sup>
	Residual	637.932	97	6.645		
	Total	639.031	98			

a. Dependent Variable: Financial Performance

b. Predictors: (Constant), Board Members' Composition

Table 4.23 discloses that the significance coefficient was 0.005 hence less than 0.05. The results therefore enabled the study reject the null hypothesis that board members' composition had a positive influence on financial performance. According to Ngo et al. (2023), the larger the board size, the more effective the decision-making process would be due to their experience and networks hence improved performance. Further, Asare et al. (2021) argued that size of the board did not make any impactful contribution towards improving performance.

#### **4.19 Multiple Regression Analysis**

Multiple regression analysis was steered to examine the influence that the four combined micro determinants (capital structure, product diversification, credit risk management and board members' composition) had on performance. This influence was measured in term of its strength through a model summary. Additionally, the purpose of the study was also determined and as well as regression weights to test the overall model of the study.

#### 4.19.1 Model Summary

A model summary analysis was conducted to ascertain how strong and what percentage influence did the micro determinants have towards improving performance as in Table 4.24.

**Table 4.24**

*Model Summary*

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.736 <sup>a</sup>	.508	.254	2.50828	1.386

a. Predictors: (Constant), Board Members Composition, Credit Risk Management, Product Diversification, Capital Structure

b. Dependent Variable: Financial Performance

Table 4.24 discloses that R was 0.736 and R-square was .508 at a Durbin-Watson value of 1.386. Thereby, it was evident that micro determinants had a 50.8% influence on financial performance which was positively correlated. The other 49.2% constituted of other elements not considered in the study. The results revealed that the micro determinants were articulate and building blocks towards improving the performance of the MFIs. In addition, Ngumo et al. (2017) looked at the factors that influence performance of MFIs in Kenya. According to their research, bank performance was influenced by factors such as microfinance size, adequate capital structure and reserves, and operational efficiency.

#### 4.19.2 ANOVA

ANOVA was used to test and ascertain whether there was any influence or not to answer the general objective of the study depending on the significance value as in Table 4.25.

**Table 4.25**

***ANOVA***

<b>Model</b>		<b>Sum of Squares</b>	<b>df</b>	<b>Mean Square</b>	<b>F</b>	<b>Sig.</b>
1	Regression	53.924	4	13.481	2.143	.002 <sup>b</sup>
	Residual	585.106	94	6.291		
	Total	639.031	98			

a. Dependent Variable: Financial Performance

b. Predictors: (Constant), Board Members Composition, Credit Risk Management, Product Diversification, Capital Structure

Table 4.25 discloses that the significance coefficient was 0.002 hence less than 0.05. The results therefore enabled the study ascertain that micro determinant had a positive influence on financial performance. Therefore, for the purposes of improving performance in the MFIs, there is need to expand more on capital structure, product diversification, credit risk management and board members' composition.

#### **4.19.3 Regression Weights**

The study's model was as follows:  $Y = C + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4$ . This where: Y = Financial Performance;  $\beta_i$  = Coefficients to be estimated; C= Constant;  $X_1$ =Capital Structure;  $X_2$  = Product diversification;  $X_3$  = Credit Risk Management and  $X_4$  = Board Composition. Therefore, the study tested the model using regression weights as indicated on Table 4.26.

**Table 4.26**

***Regression Weights***

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	13.893	3.369		4.124	.000
Capital Structure	.545	.329	.403	1.656	.101
Product Diversification	.173	.167	.187	1.033	.304
Credit Risk Management	.083	.070	.120	1.178	.242
Board Members Composition	-.483	.216	-.482	-2.238	.028

a. Dependent Variable: Financial Performance

Based on findings in Table 4.26, the coefficient of constant was 13.893, capital structure was 0.545, product diversification was 0.173, credit risk management was 0.083, and board members' composition was -0.483. Therefore, when equated to the equation:  $Y = 13.893C + 0.545X_1 + 0.173X_2 + 0.083X_3 - 0.483X_4$ . The results indicated that a unit of capital structure, product diversification, credit risk management and board members' composition, resulted to an increase or decrease in performance by  $13.893C + 0.545X_1 + 0.173X_2 + 0.083X_3 - 0.483X_4$  correspondingly.

Notably, it was paramount that when tested separately, all the micro determinants were significant but when combined, board members' composition was insignificant. This means that there was need to embrace more diversity among board members and also incorporate more members which skills, attributes, experience and networks. Further, the boards need to collectively establish timelines and policy framework on the decision-

making processes to reduce time wastage. Comparatively, Ademola et al. (2022) established that the size and composition of the board had a positive contribution to performance but based on how they approached the whole phenomenon of decision-making process. Additionally, Adusei (2019) pointed that diversity in terms of gender had a negative effect on technical efficiency, however the proportion varies depending on the size of the MFI.

## **CHAPTER FIVE**

### **SUMMARY, CONCLUSIONS AND RECOMMENDATIONS**

#### **5.1 Introduction**

The main objective of the study was to determine the influence of micro determinants on financial performance of microfinance institutions in Nairobi County, Kenya. The specific objectives were to assess the influence of capital structure, product diversification, credit risk management and board members' composition on financial performance of microfinance institutions in Nairobi County, Kenya.

The study applied descriptive research design during the collection of data. The study's target population was 14 MFIs. Further, the respondents were 185 respondents. Additionally, the study selected the sample size simple random sampling method to obtain 19 operations managers, 34 tellers, 40 credit officers, and 28 customer care officers, which was a total of 121 respondents. The study collected primary and secondary data whereby close-ended questionnaires and secondary data collection form was used respectively.

#### **5.2 Summary of Results**

The study gives a rundown of the discoveries of the review in light of every objective.

##### **5.2.1 Financial Performance**

The secondary data collected indicated that the gross profit had the highest mean of 3.5, followed by ROE which had a mean of 3.1. The ROA and net profit had the lowest mean of 2.4 and 2.9 respectively. Further, the questionnaire results disclosed that 87(89%) strongly agreed and 8(8%) agreed (mean of 4.81) that the use of various capital structure

mix had increased return on equity and that the quality decisions made on reduction of operational expenses by the board members resulted to increased net income. Nevertheless, 6(6%) strongly disagreed and 42(43%) disagreed (mean of 2.96) that the gross income had expanded since there were less losses experienced from defaulted loans as a result of quality credit risk management structure.

### **5.2.2 Capital Structure**

The questionnaire results disclosed that 89(91%) strongly agreed and 9(9%) agreed (mean of 4.91) that their MFIs offered common stock as part of raising the share capital. Further, 91(93%) strongly agreed and 6(6%) agreed (mean of 4.90) that preference stock subscribers were highly sorted since they invested in huge amounts. Nevertheless, 19 (19%) strongly disagreed and 30(31%) disagreed (mean of 2.92) that the management allowed a portion of retained earnings to be ploughed back to the operations of the MFI as a measure of reducing the cost of borrowing. Additionally, under model summary, R was 0.729 and R-square was .531 at a Durbin-Watson value of 1.428. Thereby, it was evident that capital structure had a 53.1% influence on financial performance which was positively correlated. In addition, the significance coefficient of ANOVA was 0.002 hence less than 0.05. The results therefore enabled the study reject the null hypothesis

### **5.2.3 Product Diversification**

The questionnaire results disclosed that 87(89%) strongly agreed and 9(9%) agreed (mean of 4.83) that there were efforts from the management to allow the existence of different types of loan products with various requirements. Further, 38(39%) strongly agreed and 49(50%) agreed (mean of 4.16) that the MFI had employed qualified staff that manage

various insurance accounts whereby they were able to release funds to clients when the unfortunate events happened. Nevertheless, 21(21%) strongly disagreed and 19(20%) disagreed (mean of 2.92) that the staff were always encouraged to offer suggestions to the management on how products could be improved further to incorporate the needs of each customer. Additionally, under model summary, R was 0.746 and R-square was .557 at a Durbin-Watson value of 1.442. Thereby, it was evident that product diversification had a 44.3% influence on financial performance which was positively correlated. Further, the significance coefficient of ANOVA was 0.001 hence less than 0.05. The results therefore enabled the study reject the null hypothesis.

#### **5.2.4 Credit Risk Management**

The questionnaire results disclosed that 40(41%) strongly agreed and 44(45%) agreed (mean of 4.94) that clients were always informed through writing and direct communication on how, when and the amounts they were supposed to repay on their loans. Nevertheless, 41(42%) strongly disagreed and 19(20%) disagreed (mean of 2.35) that the credit officers were highly trained on various techniques of ensuring that default rate was reduced such as extending the payment terms when need be. Notably, 41(42%) strongly disagreed and 18(19%) disagreed (mean of 2.38) that the MFI had invested in ICT systems that enabled the credit officers manage their loan portfolios adequately to monitor disbursed loans. Additionally, under the model summary, R was 0.651 and R-square was .424 at a Durbin-Watson value of 1.834. Thereby, it was evident that credit risk management had a 42.4% influence on financial performance which was positively correlated. Further, the significance coefficient of ANOVA was 0.008 hence less than 0.05. The results therefore enabled the study reject the null hypothesis

### **5.2.5 Board Members' Composition**

The questionnaires results disclosed that 78(80%) strongly agreed and 12(12%) agreed (mean of 4.64) that the current members of the board were highly skilled and contained positive attribute that was utilized in steering the MFI's policy structure. Additionally, 78(80%) strongly agreed and 12(12%) agreed (mean of 4.47) that the MFIs had benefitted a lot from the experience and network of the board members through increased customer numbers who deposited and saved their money with the institution. Nevertheless, 49(50%) strongly disagreed and 19(19%) disagreed (mean of 2.62) that the decision-making process among board members was swift since they were objective in their contribution to policies. Additionally, under the model summary, R was 0.783 and R-square was .613 at a Durbin-Watson value of 1.408. Thereby, it was evident that board members' composition had a 61.3% influence on financial performance which was positively correlated. Further, the significance coefficient was 0.005 hence less than 0.05. The results therefore enabled the study reject the null hypothesis.

### **5.2.6 Results on the Overall Model of the Study**

The model summary results indicated that R was 0.861 and R-square was .741 at a Durbin-Watson value of 1.386. Thereby, it was evident that micro determinants had a 74.1% influence on financial performance which was positively correlated. Further, the significance coefficient of ANOVA was 0.002 hence less than 0.05. The results therefore enabled the study ascertain that micro determinant had a positive influence on financial performance. The regression model coefficients included: constant=13.893, capital structure=0.545, product diversification=0.173, credit risk management=0.083, and board members' composition = -0.483. Therefore, a unit of capital structure, product

diversification, credit risk management and board members' composition, resulted to an increase or decrease in performance by  $13.893C + 0.545X_1 + 0.173X_2 + 0.083X_3 - 0.483X_4$  correspondingly.

### **5.3 Conclusion of the Study**

The study structured the conclusions based on each objective as shown in section 5.3.1 to 5.3.4.

#### **5.3.1 Capital Structure**

The conclusion made on capital structure was that MFIs' management had failed to balance between raising their capital from the share capital and other forms of funding. This resulted to new owners who demanded results in dividends paid. Therefore, this affected the balances taken to the CBK reserves and re-invest back into business since most of the profits was used to please the shareholders.

#### **5.3.2 Product Diversification**

The conclusions made on product diversification was that the management failed to incorporate various improvement suggestions made on the different implemented products. As a result, the MFIs had many products with glaring issues hence not able to amicably serve the client needs. Some of the problems with the products could be many requirements, high amounts of initial maintenance fee, high monthly maintenance fee, low interest in comparison to what other financial institutions such as what banks and sacco's were offering. The issues gave a major reason why MFIs revenue was declining in Kenya. That is, in as much as they had different products, the specific client needs were not being met and if they were met, it was very expensive to maintain the products.

### **5.3.3 Credit Risk Management**

The conclusions made on credit management was that the system failure part of the MFI on monitoring credit was a big challenge and as well a training of staff on debt recovery. It was concluded that most debt recovery departments were located at head offices and not branches. This therefore resulted to poor debt recovery methods in the branches leading to numerous default rates that were dragged to court corridors since the borrowers have evidence to have paid the debt whereas the systems of the MFI did not reflect on the same.

### **5.3.4 Board Members' Composition**

The study concluded that the board members lacked a policy framework on the frequency and range of timelines when decision should be made and if they did, they did not put it into practice. This could be attributed to the fact that they lacked enough evidence of the need for a change of policy or aspect and also did not want to be blamed for developing policies that led to declined performance. This is because the shareholders would hold them accountable on any ineffective financial strategic policy, which could at times come with a cost attributed. Therefore, to avoid this, the board members took their time to make decision which was also faced with jeopardy since its implementation became irrelevant to the evolving needs of the banking market.

## **5.4 Recommendations of the Study**

The study structured the recommendations on each objective as shown in section 5.4.1 to 5.4.4.

#### **5.4.1 Capital Structure**

The study recommends that the MFIs' board of management should provide a reliable policy framework on payment structure, whereby profits earned are shared using a known formula and not based on the demands of the shareholders. In cases where such payment policy structure exists, it should be strictly adhered to and any forced deviations should attract legal procedures for the greater good of the MFI as a going concern.

#### **5.4.2 Product Diversification**

The study commends that the BOM of MFIs should commission a special committee of expert to review the requirement of each and every product being offered. The review should incorporate both the market and competitors' rates, so as to ensure they roll out profitable products. Additionally, the shareholders should demand an existence of a policy where the junior staff have a direct access to senior management without too much bureaucracy. This was because the bureaucracy was hurting the operations of the MFIs, as far as product diversification is concerned.

#### **5.4.3 Credit Risk Management**

The study recommends that there should be a thorough audit of the ICT financial systems used by the MFI to ensure that it works seamlessly. Further, the board of management should incorporate the debt recovery department in each branch to compliment the operations of credit management. The department should have qualified staff that have enough skills, experience and could train the other staff on how to recover different debts at each stage.

#### **5.4.4 Board Members' Composition**

The study recommends that there should be a clear framework developed through a consensus meeting with shareholders' representative. This would put a timeline to the life cycle of a decision-making process. This would ensure that the board members become more articulate and precisely come up with solutions that can be applied on time. Further, the management should equip and fund a research department within the headquarter of the MFIs whereby, they keep accurate records which could be easily produced when needed during the board of members meetings.

#### **5.4 Suggestions for Future Studies**

The study assessed the micro determinants on financial performance of microfinance institutions in Nairobi County, Kenya. Future studies could expand to other financial institutions like the commercial banks and Saccos in other counties and nations. The main micro determinants assessed were capital structure, product diversification, credit management and board members' composition. Future studies could expand to other factors such as environmental diversification, staff composition, investment risks among others.

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## **APPENDICIES**

### **Appendix I: Introduction Letter**

Margaret Wanja James  
P.O. BOX 267 – 60200,  
Meru-Kenya.

9<sup>th</sup> June, 2023.

Dear sir/ madam,

#### **RE: REQUEST TO PARTICIPATE IN THE STUDY**

I am a student at Kenya Methodist University. I am conducting research on the influence of micro determinants on financial performance of microfinance institutions in Nairobi County, Kenya.

I have identified you as a resourceful person in this study hence required to kindly fill in the attached questionnaire to the best of your knowledge. Please note that this practice is voluntary and will not be offered any rewards after completion. That is, if you feel that you do not want to participate, please return the unfilled questionnaire to the researcher. Any information obtained for this study will be kept strictly confidential and will only be used for academic purposes. Do not write your name in the questionnaire. Your cooperation will be highly appreciated.

Yours faithfully,

Margaret Wanja James  
Bus-3-0066-1/2016

## Appendix II: Questionnaires

This

### SECTION A: DEMOGRAPHIC INFORMATION

#### 1. What is your job position

- Operations manager (     )  
Teller officer (     )  
Credit officer (     )  
Customer care officer (     )

#### 2. How long have you worked in this MFI

- Over 10 years (     )  
6-10 years (     )  
1-5 years (     )  
Less than 1 year (     )

#### 3. Please indicate your monthly income range

- Above 100,000 years (     )  
50,001-100,000 years (     )  
10,001-50,000 years (     )  
Less than 10,000 (     )

### SECTION B: INFLUENCE OF CAPITAL STRUCTURE ON FINANCIAL PERFORMANCE

The section seeks to assess the influence of capital structure on financial performance. Kindly respond with the response that matches your opinion. Please tick as appropriate in the boxes. 1-strongly disagree, 2-disagree, 3-neutral, 4, agree, 5- strongly agree.

No	Statement	1	2	3	4	5
1.	This MFI offers common stock as part of raising its share capital					
2.	There are clear policies that guide on which type of debt that the MFI hold at any particular financial year					

3.	Preference stock subscribers are highly sorted since they invest in huge amounts					
4.	Management allows a portion of retained earnings to be ploughed back to the operations of the MFI as a measure of reducing the cost of borrowing					
5.	The MFI has invested in modern ICT system to monitor and evaluate the capital structure levels, as a measure of maintaining the minimum required threshold at all times					

### **SECTION C: INFLUENCE OF PRODUCT DIVERSIFICATION ON FINANCIAL PERFORMANCE**

The section seeks to assess the influence of product diversification on financial performance. Kindly respond with the response that matches your opinion. Please tick as appropriate in the boxes. 1-strongly disagree, 2-disagree, 3-neutral, 4, agree, 5- strongly agree.

No	Statement	1	2	3	4	5
1.	There are efforts from the management to allow the existence of different types of loan products with various requirements					
2.	Customers are encouraged to increase the amounts in the savings accounts through group savings					
3.	The MFI has employed qualified staff that manage various insurance accounts whereby they are able to release funds to clients when the unfortunate events happen					
4.	There are direct benefits associated to deposit accounts that clients hold in the MFI such as lower requirements needed when securing a loan with the institution.					
5.	The staff are always encouraged to offer suggestions to the management on how products could be improved further to incorporate the needs of each customer					

### **SECTION D: INFLUENCE OF CREDIT RISK MANAGEMENT ON FINANCIAL PERFORMANCE**

The section seeks to assess the influence of credit risk management on financial performance. Kindly respond with the response that matches your opinion. Please tick as

appropriate in the boxes. 1-strongly disagree, 2-disagree, 3-neutral, 4, agree, 5- strongly agree.

No	Statement	1	2	3	4	5
1.	There is a catalogue such as use of Basel I, II and III guidelines that provides the requirements needed for any loan application to simplify the process of borrower assessment by the staff					
2.	Clients are always informed through writing and direct communication on how, when and the amounts they are supposed to repay on their loans					
3.	The MFI has invested in ICT systems that enable the credit officers manage their loan portfolios adequately to monitor disbursed loans					
4.	The credit officers are highly trained on various techniques of ensuring that default rate is reduced such as extending the payment terms when need be					
5.	There are more than two credit officers required to approve a loan application					

#### **SECTION E: INFLUENCE OF BOARD MEMBER'S COMPOSITION ON FINANCIAL PERFORMANCE**

The section seeks to assess the influence of board member's composition on financial performance. Kindly respond with the response that matches your opinion. Please tick as appropriate in the boxes. 1-strongly disagree, 2-disagree, 3-neutral, 4, agree, 5- strongly agree.

No	Statement	1	2	3	4	5
1.	Board members are allowed to contribute their own independent opinion to increase diversity in decisions					
2.	The current members of the board are highly skilled and contained positive attributes that are utilized in steering the MFI's policy structure					
3.	The MFI has benefitted a lot from the experience and network of the board members through increased customer numbers who deposit and save their money with the institution.					
4.	The decision-making process among board members is swift since they are objective in their contribution to policies					

<b>5.</b>	The MFI's management is keen in ensuring that they appoint board members of high integrity					
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## SECTION F: FINANCIAL PERFORMANCE

The section seeks to assess financial performance. Kindly respond with the response that matches your opinion. Please tick as appropriate in the boxes. 1-strongly disagree, 2-disagree, 3-neutral, 4, agree, 5- strongly agree.

<b>No</b>	<b>Statement</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
<b>1.</b>	The use of various capital structure mix has increased return on equity					
<b>2.</b>	Product diversification has increased the returns made on assets					
<b>3.</b>	The gross income has expanded since there are less losses experienced from defaulted loans as a result of quality credit risk management structure					
<b>4.</b>	Quality decisions made on reduction of operational expenses by the board members have resulted to increased net income					
<b>5.</b>	There is an influence of micro-determinants on financial performance					

### Appendix III: Secondary Data Collection Form

**Microfinance Institution's Name**.....

Financial Metrics				
	2018	2019	2020	2022
Return on assets				
Return on Equity				
Gross Profit				
Net profit				

## Appendix IV: Introduction Letter from KeMU



KENYA METHODIST UNIVERSITY

P. O. Box 267 Meru - 60200, Kenya

Fax: 254-64-30162

Tel: 254-064-30301/31229/30367/31171

Email: [deanrd@kemu.ac.ke](mailto:deanrd@kemu.ac.ke)

DIRECTORATE OF POSTGRADUATE STUDIES

June 27, 2023

Commission Secretary  
National Commission for Science, Technology and Innovations  
P.O. Box 30623-00100  
**NAIROBI**

Dear Sir/Madam,

**RE: MARGARET WANJA JAMES (REG. NO. BUS-3-0066-1/2016)**

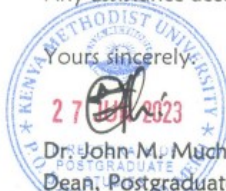
This is to confirm that the above named is a bona fide student of Kenya Methodist University, in the Department of Business Administration, undertaking a Master's Degree in Business Administration. She is conducting research on; "Influence of Micro Determinants on Financial Performance of Microfinance Institutions in Nairobi County, Kenya".

We confirm that her research proposal has been defended and approved by the University.

In this regard, we are requesting your office to issue a research license to enable her collect data.

Any assistance accorded to her will be highly appreciated.

Yours sincerely,



**Dr. John M. Muchiri (PhD)**  
**Dean, Postgraduate Studies**

Cc: Dean SBUE

CoD, Business Administration  
Postgraduate Coordinator  
Supervisors

## Appendix V: NACOSTI Permit

 <b>REPUBLIC OF KENYA</b>	 <b>NATIONAL COMMISSION FOR SCIENCE, TECHNOLOGY &amp; INNOVATION</b>
Ref No: <b>332048</b>	Date of Issue: <b>13/July/2023</b>
<b>RESEARCH LICENSE</b>	
	
<b>This is to Certify that Miss. MARGARET WANJA JAMES of Kenya Methodist University, has been licensed to conduct research as per the provision of the Science, Technology and Innovation Act, 2013 (Rev.2014) in Nairobi on the topic: INFLUENCE OF MICRO DETERMINANTS ON FINANCIAL PERFORMANCE OF MICROFINANCE INSTITUTIONS IN NAIROBI COUNTY, KENYA for the period ending : 13/July/2024.</b>	
License No: <b>NACOSTI/P/23/27570</b>	
<b>332048</b>	
<b>Applicant Identification Number</b>	<b>Director General</b>
	<b>NATIONAL COMMISSION FOR SCIENCE, TECHNOLOGY &amp; INNOVATION</b>
	<b>Verification QR Code</b>
	
<b>NOTE: This is a computer generated License. To verify the authenticity of this document, Scan the QR Code using QR scanner application.</b>	
<b>See overleaf for conditions</b>	

## Appendix VI: Microfinance Institutions in Kenya

No.	Microfinance
1.	Branch Microfinance Bank Limited (formerly Century)
2.	Caritas Microfinance Bank Limited
3.	Choice Microfinance Bank Limited
4.	Daraja Microfinance Bank Limited
5.	Faulu Microfinance Bank Limited
6.	Kenya Women Microfinance Bank Limited
7.	LOLC Microfinance Bank PLC. (formerly ReMU)
8.	Maisha Microfinance Bank Limited
9.	Muungano Microfinance Bank Limited
10.	Salaam Microfinance Bank Limited (formerly Uwezo)
11.	SMEP Microfinance Bank Limited
12.	Sumac Microfinance Bank Limited
13.	U & I Microfinance Bank Limited
14.	Rafiki Microfinance Bank Limited

Source (CBK, 2022)