Influence of Product Diversification on Financial Performance of Microfinance Institutions in Nairobi County, Kenya.

Influence of Product Diversification on Financial Performance of Microfinance Institutions in Nairobi County, Kenya.

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Abstract

Purpose: To examine the influence of product diversification on financial performance of microfinance institutions in Nairobi County, Kenya.

Methodology: The study applied descriptive research design during the collection of data. The study's target population was 14 microfinance banks. The sample size was selected using simple random sampling method after determination using Kothari (2004) sampling formular to obtain 19 operations managers, 34 tellers, 40 credit officers, and 28 customer care officers. The study collected primary and secondary data. 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 and 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.

Results: 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. 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. Further, the significance coefficient of ANOVA was 0.001 hence less than 0.05. The results therefore enabled the study reject the null hypothesis.

Unique contribution to theory, policy and practice: The conclusions made on product diversification was that the management failed to incorporate various improvement suggestions made on the different implemented products. 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.

The study recommends that the management of MFIs should commission a special committee of expert to review the requirement of each and every product being offered.

Keywords: *Product Diversification, Financial Performance, Microfinance Institutions in Nairobi County, Kenya.*

1.0 INTRODUCTION

Financial performance is the assessment of the financial health of a Micro Finance Institutions [MFIs] such that it's able to funds operations drawing revenue from various sources (Central Bank of Kenya [CBK], 2021). In MFIs' performance is of essence since it provides clients a chance to look into the wellbeing of the institutions. However, MFIs have been struggling with performance issues.

Globally, MFIs in American states such as Georgia, they 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 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 asTanzania, MFIs have been experiencing 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). Therefore, diversifying their products such as MFIs broadening the revenue sources through introducing different deposit accounts, saving accounts and loans in their operations, could enhance the performance (Maranga et al., 2022).

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 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).

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.

1.3 Purpose of the Study

To examine the influence of product diversification on financial performance of microfinance institutions in Nairobi County, Kenya.

1.4 Hypothesis of the Study

H_01: Product diversification has no significant influence on financial performance of microfinance institutions in Nairobi County, Kenya.

2.0 LITERATURE REVIEW

2.1 Theoretical Review

Resource Based View Theory was advanced by Wernerfelt (1984) and 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 intagible resources include good will, organization culture and employees qualification interms of experience and academic qualifications. All these elements when propely utilized, they result to increased revenue and the insitution'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 laons, 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 oeprations to improve their performance.

2.2 Empirical Review

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 (2020) 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 (2020) 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.

3.0 RESEARCH METHODOLOGY

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 24 operations managers, 53 tellers, 68 credit officers, 40 customer care officers hence a sum of 185 respondents. The sample size was selected using simple random sampling method after determination using Kothari (2004) sampling formular to obtain 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.

4.0 RESULTS

4.1 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 1 gives the response rate.

Table 1: *Response Rate*

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

Table 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.

4.2 Reliability Test Results

The study conducted a pre-test study of the questionnaires 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 presented in Table 2.

Table 2: *Reliability Test Results*

Variable	Cronbach Alpha	No of Item
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 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 from the study's pre-test proved that the data collection instruments were reliable hence could be re-used over and over to give an accurate and similar results.

4.3 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 3.

Table 3: *Secondary Data Results of Financial Performance*

Variable	N	Mean
ROA	14	2.4
ROE	14	3.1
Gross Profit	14	3.5
Net Profit	14	2.9

Table 3 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 presented in Table 4.

Table 4: *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 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.

4.4 Descriptive Results of Product Diversification

The questionnaire had five questions relating to product diversification and its results are presented in Table 5.

Table 5: *Descriptive Statistics of Product Diversification*

Statements N=98	1	2	3	4	5	Mean
There are efforts from the management to allow the	2(2%)	0(0%)	0(0%)	9(9%)	87(89%)	4.83

existence of different types of loan products						
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 5 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.

4.5 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 6.

Table 6:*Model Summary of Product Diversification*

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.746[a]	.557	.545	2.54791	1.442

a. Predictors: (Constant), ProductDiversification

b. Dependent Variable: FinancialPerformance

Table 6 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.

4.6 ANOVA of Product Diversification

ANOVA was used to test the hypothesis on the variable of the study to ascertain whether the null hypothesis be accepted or rejected depending on the significance value as shown in Table 7.

Table 7: *ANOVA of Product Diversification*

Model		Sum of Squares	df	Mean Square	F	Sig.
	Regression	15.814	1	15.814	2.436	.001[b]
1	Residual	623.217	97	6.492		
	Total	639.031	98			

a. Dependent Variable: FinancialPerformance

b. Predictors: (Constant), ProductDiversification

Table 7 discloses thatthe 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.

4.7 Regression Weights

The study's model was as follows: $Y = C + \beta_1 X_1$ where: Y = Financial Performance; β_i = Coefficients to be estimated; C= Constant, and XI= Product diversification. Therefore, the study tested the model using regression weights as indicated on Table 8.

Table 8: *Regression Weights*

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
	(Constant)	13.893	3.369		4.124	.000
1	Product Diversification	.173	.167	.187	1.033	.304

a. Dependent Variable: Financial Performance

Based on findings in Table 8, the coefficient of constant was 13.893, and product diversification was 0.173, Therefore, when equated to the equation: $Y = 13.893C + 0.173X1$. The results indicated that a unit of product diversification, resulted to an increase in performance by $13.893C + 0.545X1$.

5.0 SUMMARY, CONCLUSION AND RECOMMENDATION

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 Conclusion

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 saccos 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 Recommendationand Contributions of the Study

The study recommends that the management 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.

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