RELATIONSHIP BETWEEN FINANCIAL MANAGEMENT PRACTICES AND FINANCIAL PERFORMANCE OF THE MICROFINANCE INSTITUTIONS IN KENYA

BY

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DECLARATION

I do declare that this Research project is my original work and has not been submitted to any other university for any kind of an academic award**.**

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SUPERVISOR'S APPROVAL

This research project has been submitted for examination with my approval as the university supervisor.

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SIGNATURE:…………………………………. DATE:……………………

DEDICATION

I wish to dedicate this project to my dear parents Mr. Peter Macharia and the Late mum Eunice Wambui Macharia and all my brothers and Sisters

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I wish to acknowledge the Almighty God For the gift of life and good health and for his providence that has enabled me to study this far.
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THANK YOU ALL AMD MAY GOD BLESS YOU.

LIST OF ABBREVIATIONS

AIS	:	Accounting Information Systems
AIS	:	Accounting Information Systems
AMFI	:	Association of microfinance Institutions
CBA	:	Cost Benefit Analysis
CBK	:	Central Bank of Kenya
CSM	:	Capital Structure Management
EVA	:	Economic Value Added
FAM	:	Fixed Asset Management
FRA	:	Financial Reporting and Analysis
MFIS	:	Micro Finance Institutions
NGOs	:	Non-Governmental Organization
NOPAT	:	Net operating profit before interest and after tax
ROA	:	Return on Assets
ROCE	:	Return on capital employed
SACCOS	:	Savings and Credits Cooperative Society
SMEs	:	Small Medium Enterprises
SPSS	:	Statistical Package for Social Sciences
WACC	:	Weighted Average Cost of Capital.
WCM	:	Working Capital Management

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ABSTRACT.

This study sought to establish the relationship between Financial Management practices and financial performance of Microfinance Institutions in Kenya. The major objectives of these study were to establish various financial practices adopted by various Microfinance organizations in Kenya and to determine the relationship between financial management practices and financial performance of various microfinance organizations in Kenya. This was anchored on the three theories which included; the contingency Theory, The residual equity theory and the proprietorship theory. The determinants of financial perfomamance included, working capital management, Return on Investments, Return on Assets, Returns on Capital Employed, Cost Benefit Analysis. The study relied on the descriptive survey design as its research design, data was collected using the data collection sheet, the target population were the 13 microfinance organizations in Kenya, data was analyzed using SPSS and other descriptive statistsics.Among the findings of this study includes, There exists a negative relationship between financial management practices and financial performance of the microfinance organization, also the study established that there is a significant relationship between liquidity levels,assests quality and management quality of the MFIs and the financial perfomamance of the MFIs.Finally the study revealed an insignificant positive relationship between earnings quality, and MFIs perfomance.The study therefore recommended that MFIs should have an optimal financing mix so as to ensure that their ongoing concerns are assured all the times, That MFIs should maintain higher levels of capital cover for its costs and losses, proper management of the MFIs earnings, MFIs should have sufficient liquidity all the times, effective management of the loans as well as ensure there is efficient operations of the MFIs.all these recommendations were aimed at helping the MFIs to boost on their performance.

CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

Pandey (2010) defines financial management as that strategy where both public and private organizations design, execute and analyze policies that helps them to maintain discipline in financial decisions. These strategies are both medium term, long term as well as short term; however whether a strategy is long term, short term or medium term, it's meant to enhance the value of the organization financially so that minimization of costs and maximization of profits is enhanced.

Gitman (2011) noted that financial management means the relationship between the concepts of time, money and risks. Both at a personal level and at organizational level, management of finances requires that one is able to execute his plans in relation to the amount finances he has. This therefore requires serious planning and control of how one uses his finances. In the modern world, the idea of managing a company's finances is modern world, the idea of managing a company finances is divided into three major decision making strategies. They include, decisions based on investments, decisions based on fiancés as well as decision based on sharing of dividends (Brealey and Myers 2007).

Brealey and Myers (2007) observed that making decisions on investments requires that the merging of the working capital (current assets) and that of capital budgeting is adhered to, while decisions based on the finances requires that the source of finances, period of financing, the costs related to the acquired finances, as well as the returns that the business venture brings are adhered to proper management of an organizations finances through financial management practices is critical in raising the levels of an organizations profitability and it gives the organization in question a financial clean bill of financial position.

1.1.1 Financial Management Practices

Moore and Reichert (1989) defines financial management practices as those actions or skills done by an accountant, chief financial Officer together with the board of management in the budgeting area, procurement and supply, management of assets as well as the control of an organizations finances. Popular financial management practices that organizations use are as follows; Financial Reporting and Analysis (FRA), Fixed Asset Management (FAM) Accounting Information Systems (AIS), Working Capital Management (WCM) as well as the Capital Structure Management (CSM). These practices are very important in ensuring that organizations are properly managed in the financial sense.

Accounting Information Systems (AIS) refers to an integrated framework within an organization that employs physical resources such as the materials supplies, personal, equipment as well as the finances in order to transform economic data into financial information (Bhat 2001). This view is shared by that of Thomas and Kleiner 1998) who notted that Accounting Information Systems (AIS) helps an organization to conduct its operations as well as to discharge on its mandate. This information will later on be shared with interested persons. This means that the interface between human skills, technological skills will greatly assist the company in question to make good use of the knowledge it has on a very effective manner.

Working capital according to Keown, Petty and Scolt (2008) refers to a portion of the assets of an organization. This therefore means that total number of current and investment assets that a company owns and is able to convert it into cash within the year. It requires that the costs be minimized and profits be maximized.

Capital structure according to Boateng (2004) refers to as the relative amount of debt and equity used to finance a firm. It therefore means that short term debts, long-term debt, preferred stock as well as common equity are the major sources of accompany finances, capital structure is therefore a subset of a financial structure which represents the permanent sources of an organizations finances.

Accounting Information Systems according to Romney (2009) helps on organization to analyze its financial position using the financial statements. The author further argues that computer-based accounting information system are a good tool that is reliable in financial accounting since its automated as well as streamlined. It's easier to generate reports. Gitman 2011 on the other hand notes that a good Financial Reporting Analysis (FRA) records, organization as well as accounting information systems won't be beneficial unless the reports generated by the systems are critically analyzed and relied upon in making decisions at the level of the management. Garrison (1999) defines Working Capital Management (WCM) as that process of making decisions which relates to working capital in relation to short time financing. This consists of regulation of the interface between organization short-term assets in relation to its short term liabilities.

Fixed Assets Managing (FAM) according to Garrison (1999) refers to that process of accounting which helps to track non-current assets of an organization in abide to ensure financial accounting, preventive maintenance as well as theft difference capital structure management (CSM) on the other hand refers to the art and science of overseeing of the capital structure of the company. The organizations capital structure means a combination of an organization multiple sources of finance. This is because most organizations finances are sourced from debts as well as equity.

1.1.2 Financial Performance

Mcmahon (1995) defined financial performance as a subjective measure of how well on organization is able to utilize its assets from its operations and generate more income. It may also refer to the company’s overall financial position in a certain period of time. This is financial position is useful in comparison purposes with other companies in the similar sector or industry. It can also be used for industrial comparison purposes after amalgamation or aggregation has taken place.

The performance of organizations in the financial sense is arrived at through the reliance of accounting information or stock market values in the context of financial management practices. In case one relies or uses the value of company stock markets, this will mean that a shift in the market value of a company in the stock market is assessed. The performance of an organization therefore is measured through the shift of a company’s value in the stock market annually. It’s arrived at through the calculations of accompany annual stock price changes.

In the usage and the application of accounting information systems. Accounting ratios are mostly used. The most common accounting ratios are as follows, the return on assets (ROA) as well as the Return on capital employed (ROCE). The return on assets (ROA) indicates how an organization has been generating its profits as compared to the total assets that it owns. This in turns helps to gauge the performance of a company’s management on how efficient they are in profit making using a company’s assets, it’s displayed in percentages and it’s arrived at by dividing an organization’s annual profits by its total assets.

Because of the challenges associated in using stock market prices, this study utilized the services of the return on assets (ROA) in the measurement of the operational efficiency of micro-finance organizations in Kenya.

1.1.3 Relationship between Financial Management Practices and Financial Performance

Moore and Reichert (1989) argued that the interface between financial management practices and the performance of organizations must put in mind that there exist other variables which may accelerate or de-accelerate the levels of performance. Although the said factors do not directly influence the inter-face, between financial management practices and the performance of organization. The authors insist that they must be put into consideration. So as to eliminate their impact on an organization’s performance.Padachi (2010) points out that the main factors that contribute to success or failure of business are categorized as internal and external factors. External factors include financing (such as the availability of attractive financing), economic conditions, competition, government regulations, technology and environmental factors. The internal factors are managerial skills, workforce and the accounting systems.

The said factors may include the size of the company, its level of capital intensity, and its degree of risk; accompany level of leverage as well as the industrial attributes like growth, company advertisements, research level, development level as well as a company’s level of the market share. This study will factor in all the said factors and regard them as control variables. McMahon (1995) notes that the major aim of managing a company’s finances is to improve on the amount of assets that a company owns. This central aim can be best understood in specific aims such as raining the levels of profits and increase on the levels of liquidity. Management of profits is arrived at through maintenance or an increment of a company's earnings that comes about as a series of controlling costs, proper policies on pricing, volumes of sales, proper management of the inventories, and expenses on capital acquisition.

The author continues to argue that management of the levels of a company's liquidity requires that a company's costs are sorted out in the right time; these costs may include wages, bills, loans, taxes among others. He finalizes by observing that financial management is also aimed at promoting the growth of an organization and increases the profit levels as well as an increment in a company's market share prices in the security and stock markets. This will greatly improve on the value of an organization in question in the long term.

1.1.4 Microfinance Organizations in Kenya

According to Kwan &Eisenbels (2005) microfinance institutions refers to those financial institutions which have been dedicated to assist small enterprises, the poor households and the downgraded who may not have a sufficient access to the more institutionalized financial systems in securing loans, making savings, getting access to financial services, the authors continue to observe that through these micro-finance organizations, small enterprises, and individuals with low incomes as well as local women have been able to successful run small businesses that may means a lot to countries that are still developing. These micro-finance organizations according to Jorian (1997) range from the NGOs, SACCOS, and commercial micro-finance institutions& regulated specialized providers.

In (1991) the Association of microfinance Institutions (AMFI) got government registration through the societies act. It acted as an umbrella body to represent microfinance organizations in Kenya. This body is responsible for among other things, supporting MFIS, in fostering growth and developments, promotion of efficient and effective delivery of microfinance services just to mention at a few. Kenya consists of more than 250 MFIS, which practice some form of microfinance, 3 of which are deposit taking and 17 are credit giving only, the remaining 230 MFIS combine microfinance with social welfare activities. In the 2008 microfinance Act, MFI's in Kenya can be classified into 3 tiers, namely; deposit taking institutions, such as microfinance credit only institutions and informal organizations supervised external agency other than government. This study will be interested in the deposit taking only institutions.

1.2 Research problem

In the modern world, businesses face a cut throat competition, whereby it requires that each business has a solid foundation in terms of its finances so as to be able to survive in the ever turbulent markets. As a result of these scenarios, organizations are working round the clock in order to have a closer and harmonious interaction with its stakeholders. This means that wise, proper and all inclusive decision making process is very important.

A number of scholars have argued that managers must pass a high level of effective financial management as well as IT skills so as to effectively deal with the challenging market environment. For instance in cases where organizations experience an economic downturn, managers of the said organizations must be very flexible in their altitudinal change in order to make their organizations survive. These organizations must meet all be needs and requirements of their consumers; therefore, a sound management of the company's finances is very key in improving efficiency.

Mitchell (2000) observed that accounting information system important so as to enable organizations to sort out their short-term challenges and enable the managers to make sound decisions. In the recent post, a number of studies done by various scholars have concluded that effective and management of organizations finance may contribute to the excellence of such organizations in the day's tome (Baker 2003). Other studies on the interface between financial management practices and performance of business organizations have given mixed results, for instance Moore and Reichert (1989) studied 500 firms in the United States on the link between the sue of modern analytical tools and firms performance. They found out that organizations which adopted sophisticated machines stood a higher chance of securing a better performance, than those who didn't.

At the local level, Kamande Kelvin Macharia did a study on "The relationship between financial management practices and financial performance in the dairy industry in Kenya, "he found out that" without the fair financial management practices, the financial performance of the dairy processors will be tour; also that other factors such as non-current asset management, capital structure management and working capital management do not interfere with a company's performance. Kiita Geoffrey Kitonga (2013) did a study on the relationship between financial management practices and financial performance in the shipping industry in Kenya. He found out that the performance of the shipping companies was positively impacted by the financial management practices and that most of the shipping companies have put in place financial management practices.

Berryman & Peacock (1991) did a study on various reasons as to why businesses fail; they found that among other reasons for business failure is the issue of careless financial management. Wammer (1973) on the other hand did a study of the relationship between sophisticated capital budgeting methods and financial performance in the US, he established that, despite the growing adoption of sophisticated capital budgeting methods, there was no consistent association between financial performance and capital budgeting techniques.

As it can be clearly seen in the above explanation, scholars have mixed reactions on the above relationship between financial management practices and the performance of business organizations. This study is not meant to dispute the findings of the above studies, but to complement the above findings from the micro finance organizations perspectives. This study will therefore shade more light on the financial management practices adopted by various micro finance organization’s and determine the relationship that exists between financial management practices and the financial performance of the micro-finance organizations.

1.3 Objectives of the Study

This study was guided by the following objectives.

1.3.1 Main Objective

To establish the extent to which the relationship between financial management practices and financial performance of micro-finance institution in Kenya.

1.3.2 Specific Objectives

1. To establish the various financial management practices adopted by various micro-finance organization’s in Kenya.

2. To determine the relationship between financial management practices and the financial performance of the various micro finance organizations in Kenya.

1.4 Value of the Study

The value of this study was justified at two levels, at the Academic level and at the policy level.

At the academic level, A number of studies have been on this subject of financial management practices in relationship to financial performance, most of these studies have produced mixed results, others are positive about the relationship while others do not. Secondly these studies have focused on specific organizations such as shipping firms, dairy firms and small businesses. There is no single study that has focused on the micro-finance organizations, therefore the findings of this study and the recommendations made will contribute to knowledge expansion of the existing studies and create a platform for academic debates, discussions among the students of finance and researchers interested in matters of financial management practices. This study will create a platform for further research.

At the policy level, the findings of this study and the recommendations made will create an insight on financial management practices to the practitioners of finance. The financial management practices will be critically analyzed on how it impacts on the performance of the various organizations. Secondly the study will give critical information to business organizations in general and in particular microfinance institutions on the strategies they need to adopt in order to create policies that will adopt financial management practices so as to enhance their performance.

The study will therefore identify policy loopholes and attempt to provide solutions on how to seal those policy loopholes.

Therefore managers of MFI, Board of directors and managers, the government of Kenya through the CBK, and the AMFI, will find the findings and the recommendations made by this study useful.

CHAPTER TWO

LITERATURE REVIEW

2.1 The Introduction

This chapter dealt with among other things the theoretical framework of the study. Among the theories that will be used by this study include, the contingency theory, be residual Equity theory and the propriety theory. Then the study dealt with the issue of the determinants of the financial management practices, then the empirical literature review will be explained and lastly the conceptual framework of the study will also be explained. A conclusion will be given at the end of it all.

2.2 Theoretical Framework

2.2.1 The Contingency Theory

This theory according to Pike (1986) argues that the efficiency levels of allocation of the resources is not just a matter of putting in place proper techniques, technologies and good procedures, it is also about considering the context, design as well as the operationalization of the capital budgeting system. This theory is very relevant in the sectors of management and organizational studies. It is even more relevant in the accounting profession. This theory classifies contingent variables into four major classes which include the environmental variables, user characteristics, the attributes of the organization as well as the societal variables. These four variables are very critical in the reporting system of any organization.

The theory is strengthened by the views of Schweikart (1985) who noted that the levels of accounting systems in countries differ from one state to the other since these states are characterized with different environmental factors. Therefore this theory will help the MFIs to consider other factors such as environmental societal, user characteristics and its internal attributes in the process of resource allocation. The other relevance of this theory to this study is that it helps the MFIs to devise strategies in which they can be able to survive the murky waters of business environment.

2.2.2 Residual Equity Theory

This theory was advanced by Hendricksen (1982) who notted that this theory lies in between the theory of proprietorship and the theory of entity. It argues that a shift in the value of assets, shifts in revenues, shift in profits and interests of other stakeholders are all reflected in the residual equity of the common stakeholders. These specific equities according to the author are as follows, creditors ‘claims, equities of preferred stakeholders just to mention but a few. Therefore the balance sheet of an organization will be assets minus specific equities in order to get residual equity. This therefore means that the equities of common stakeholders should be separated from those of other specific stakeholders.

The major idea in this theory according to Hendricksen (1982) is to provide the management of the organization such as the MFIs with sufficient data so that they are able to make sad decisions concerning the investments. This is because the value of a company’s stock in its current situation depends on its future dividends. Future dividends on the other hand depend on the expected total receipts minus the contractual obligations, payments made to specific equity holders and the investment requirements. This information will be good for the purposes of predication to the shareholders. The theory is very relevant to this study in that it highlights the performance of the company from time to time and it provides the indicators to the management of how the performance of the company is.This informs the management on the type of decisions to make.

2.2.3 Proprietary Theory

Rosen field (2008) noted that this theory argues that the company which is owned by an individual or a number of people is the center of focus. It's known as a proprietor. This therefore means that accounting and the issues that are included in the company's financial statements must all reflect the will of the owners or the proprietors. This is necessary so because it's the proprietors who will bear both the profits and the losses that a company makes. This idea originated from the logic of exposing the double entry problem of the entry bookkeeping where the stockholders equity =assets –liabilities. Therefore the entire asset of a MFI belongs to the owners, together with all the profits generated as well as losses incurred (Rosen field 2008). The relevance of this theory to this study is that there is no way an MFI or a company can prosper without factoring in the views and the interests of its owners who are major stakeholders of the company. Therefore the behavior of company owners or proprietors is critical in determining the performance of the organization.

2.3 Determinants of Financial Performance

These refers to those actions taken in order to measure overall effectiveness of a firm financial performance and whether it resources are effectively managed, they include the return on assets (ROA) and Return on Equity (ROE) ratios (Kangarlouei, et al., 2012:172).Other indicators include cost benefit analysis, return on capital employed (ROCE), as well as the economic value added (EVA).

2.3.1 Working Capital Management (WCM)

Garrison (1999) notted that the WCM means any decision that is made regarding the MFI's working capital and short term financing. This means that there is a correlation between a MFIs short term assets as well as its short term liabilities. The major aim of WCM is ensuring that the MFIs is able to proceed with its operations smoothly by ensuring that there is a sufficient level of cash flow in meeting both the short term debts and the emerging operational costs. This means that the sub-sets of working capital such as management of cash, payables and receivables, inventories among others are properly managed. This will performed using quick ratios such as working capital/total asset and current assets/total asset. Other measures of financial performance include:

2.3.2 Return on Investments (ROE)

This measure helps the accountant to evaluate levels of how efficient a company's investments are. This is achieved using is formulae.

ROE=Net profit after taxes x 100

Shareholder's Equity

In the above formulae, Gentille (2010) investment gains refer to the profits that have been assured from selling, or earnings that an investment has had. This is a measure which is popularly used by organization's because of how simple it is once the ROI of an MFIs is negative, then the said MFI should not accept to engage in that form of investments.

2.3.3 Return on Assets (ROA)

This according to Collins & Jarvis (2000) indicates how firm management uses its resources to generate income. This helped to bring out the levels of company efficiency in utilizing its assets. ROA is calculated as follows:-

$$ROA = \frac{\text{Net Income after Tax}}{\text{Total Assets}}$$

ROA depends on how on the MFIs have performed.

2.3.4 Returns on capital employed (ROCE)

This measure according to Romney (2009) shows the levels of efficiency and how profitable on MFI is. It is also a popular measure or determinant of financial performance. They appear in percentages forms. This measure did not only show how the quality of a MFIs management is, but the existing climate that the business environment has. MFI with a high capital returns will be more profitable. The formulae of calculating ROCE is as follows:

$$ROCE=\frac{\text{PBH (Net Income}}{\text{Capital Employed}} \times 100\%$$

Where capital employed= Total assets- current –liabilities= Equity + Non-current liabilities

2.3.5 Cost Benefit Analysis (CBA)

This measure of financial performance according to Boating (2004) is very popular with MFIS, governments and NGOs. This measure assesses the viability of a policy programmer or a profit and determines whether it’s a worth exercise or not. It relates the total benefits it will bring. If the costs outweigh the benefits then it’s not a worthy exercise under CBA, costs and liabilities are expressed in monetary terms.

2.4 Empirical Literature Review

A number of studies have been done on the subject of financial management practices and the performance of the organizations. At the Global level, these are some of the studies which have been done;

2.4.1 International evidence

D’Amboise and Gase (1980) did a study on the use financial statement analysis by small manufactures in aruebec, Canada. They established that small entrepreneurs in the shoe and plastics sector formally undertook financial reporting which informed most of their strategic decisions. This study was reinforced by that of De Thomas and Fredenberger (1968) who discovered that 81% of the SMEs’ obtained financial statements of their respective businesses regularly 91% of this financial statement took the form of balance sheets, profit as well as loss statements, fund statements among others. Others relied on bank reconciliations as well as the operations summaries. This study further revealed that 61% of the respondents that the financial statements greatly supplied them with necessary information which influenced their plans and decisions. However 11% of the respondents though that they used financial statements as part of evaluating, making plans and decisions.

Nguyen (2001) did a study on the relationship between financial management practices and profitability of the SMEs in Australia, he established that 88% of SME’s always evaluate their capital projects before taking any form of decisions regarding investments; he also established that the said SMEs gave a lot of seriousness to fixed asset management in reliance of knowledge management practices.

Kijjambi (2014), established responsibilities for financial performance of domestic banks in Uganda. The study analyzed each licensed domestic and foreign commercial banks on average basis. Data was collected from secondary source such as published financial statement for both independent and dependent variables of the study. Analysis for 10yrs using multiple linear regressions found that management efficiency, asset quality, interest income, capital adequacy and inflation are factors affecting the performance of domestic banks of Uganda at the period of the study

2.4.2 Locally evidence

Locally Mundu (1997) studies the relationship between financial management practices and the profitability of the SMEs. He established that contrary to Nguyens findings, 66% of the proprietors of the SMEs did not make any cash budgets, 70% of the proprietors instead opted to keep the cash profits physically 86% of the respondents were keeping their cash personally because of security reasons. The said entrepreneurs were also having the habit of selling their products to clients or customers on credit, especially those whom they knew.

These debts were followed by the entrepreneurs using phone calls and physically visiting the homes of the debtors.

Kamande Kelvin Macharia (2015) did a study on the relationship between financial management practices and financial performance in the dairy industry in Kenya. He found out that without dairy firms employing the four financial management practices, they are bound to fail. Also that proper management of the working capital helps the dairy firms to smoothly carry out their daily operations. This will in the long run boost the variety of the firm's financial performance.

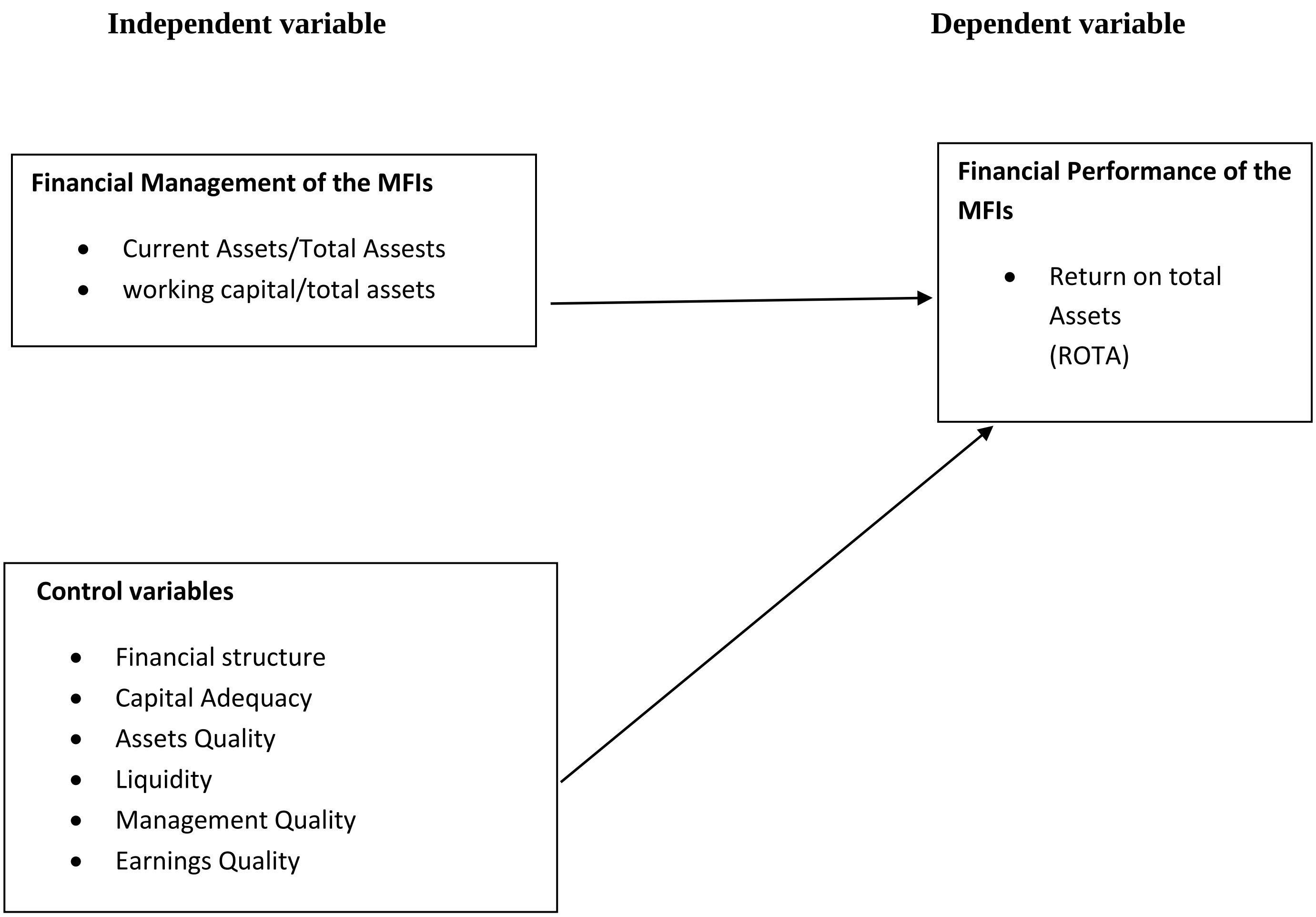
Kiita Geoffrey Kitonga (2013) did a study on the relationship between financial management practices and the financial performance in the shipping industry in Kenya. He established that most shipping companies employed various financial management practices which boosted their performance; its study therefore recommended that the shipping company should adopt the necessary measures which will ensure that the said financial management practices are improved so as to further boost the financial performance of the shipping companies. The study identified a gap on financial management and financial performance as intensively study aspect although no agreement in performance measurement has yet been reached.

2.5 Conclusion/Summary of Literature Review

From the above studies, it was seen that financial management practices has a direct correlation with the performance of organizations. A number of studies agreed with this statement while others did not. There was a sharp difference or contradictory views between the modern ways of managing on organization in relation to the traditional ways although the traditional methods of doing business showed a very weak relationship. However other studies revealed there was a negative relationship between financial management practices of business organizations with their performance. This means that by adopting financial management tools, by an organization, this is not enough in making an organization to improve on its level of performance. Other factors like levels of marketing, developing a product, recruitment of the managers and the levels of their trainings, relations among the laborers etc. also influence a company's overall performance financially.

These conflicting findings of all these studies give a reason why this study is very relevant. Secondly those others studies have dealt with particular organizations such as shipping companies, SMEs, diary firms, etc., no single study has dealt with microfinance institutions in Kenya. It is upon this background that this study seeks to establish the implications of the financial management practices on financial performance of microfinance enterprises in Kenya.

2.6. Conceptual Framework



Independent variable
Dependent variable
Financial Management of the MFIs
Current Assets/Total Assests
working capital/total assets
Financial Performance of the MFIs
Return on total Assets (ROTA)
Control variables
Financial structure
Capital Adequacy
Assets Quality
Liquidity
Management Quality
Earnings Quality

Source: Author 2018

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 The Introduction

This chapter dealt with the subject of the research design that this study employed the target population, methods of data collection, data presentation and analysis techniques among others.

3.2 The Research Design

This study adopted the descriptive survey design as its research design. This method greatly helped this study to a large number of MFIs in Kenya using a small sample (Glass & Hopkins 1984). This meant that a cross-sectional survey of all the MFIs in Kenya and a sample was picked using the purposive method. This process involved among other things information gathering, tabulating it on graphs, pie-charts and tables to enable the reader to get the distribution of data. This study sought to establish the relationship that exists between financial management practices and the performance of the microfinance institutions in Kenya.

3.3 Target Population

The target population of this study included all the microfinance institutions in Kenya that have been listed by the central bank of Kenya. They are 13 in number.

3.4 Data Collection

This study collected secondary data from financial statement and it focused on each of the financial management practice in a period between 2013-2017. The secondary data in this study was obtained from the various financial statements which have been published by the various microfinance institutions.

3.5 Data Presentation and Analysis

Data was arranged in such a way that it was coded, and tabulated before it was analyzed. These data that has been presented was analyzed using descriptive statistics such as the use of tables, pie charts as well as cross tabulations. The regression maid was used to computer the relationship that exists between financial management practices and the financial performance of the micro finance institutions in Kenya.

Y = a+b1X1+ b2X2+b3X3+b4X4+B5X5+B6X6+E

Where:

Y=financial performance measured by Return on Assets (ROTA) or Net income/Total Assets

X1=working capital as measured using Liquidity or current assets/total assets (CA/TA)

X2= The Control Variables are Financial structure, Measured as Total Liabilities/Total Assets

X3= Capital Adequacy Measured using Capital to Total Assets

X4=Assets Quality Measured as Non Preforming Loans to Total Loans

X5= Management Quality Measured as Cost to Income Ratio

X6=Earnings Quality which is measured as Net Income to Total Liability

E= Error Term

β_0= constant

$\beta 1, \beta 2, \beta 3, \beta 4, \beta 5\ and \beta 6$ Are regressions co-efficient?

Data collected was analyzed using the SPSS version 10 (statistical package for social sciences) the coefficient of determination R^2 was used to test the significance of the regression model explaining the relationship between financial management practices and the financial performance of the micro-finance institutions-tests will be used in doing further analysis of the variables that showed the financial performance of each micro finance institutions that will be under study. Tests of significance were undertaken to determine management practices on financial performances

CHAPTER FOUR: DATA ANALYSIS, RESULTS AND INTERPRETATION

4.1 Introduction

This chapter presents the results of the data analysis. The chapter contains the response rate analysis, the descriptive statistics, correlation and regression analysis and then an interpretation of the research findings.

4.2 Response Rate

The population for this study was made up of the 13 microfinance banks in Kenya. However; complete data was obtained from 9 microfinance banks. This made up a response rate of 69.23%, which was considered adequate since it was more than 50% of the target population as recommended by Mugenda and Mugenda (2003).

4.3 Descriptive Statistics

This summarizes the data using the mean, standard deviation, minimum and maximum values, skewness and kurtosis. Table 4.1 indicates the results

Table 4.1 Summary Statistics

	ROA	Financial structure	Capital adequacy	Assets quality	Liquidity	Management quality	Earnings quality
N	45	45	45	45	45	45	45
Mean	-.01467	.17924	.49631	.13007	.38471	12.28193	.73198
Std. Dev.	.062765	.361906	.496467	.154373	.236838	19.806314	1.218670
Skewness	-2.610	2.655	3.605	2.696	2.233	1.513	2.517
Kurtosis	4.028	3.443	4.087	4.951	4.329	3.617	3.282
Minimum	-.269	.000	.100	-.017	.090	-13.500	.077
Maximum	.053	2.425	3.100	.804	1.250	88.056	8.653

Source: Author 2018

The summary statistics on table 4.1 indicates that the average return for the microfinance banks was -0.01467, which indicates that the average performance of the microfinance banks in Kenya over the study period was negative. The tables indicate that average debt to assets ratio of the microfinance was 0.179, which indicates that usage of borrowing microfinance banks was at 17.9%. The results also show that the mean value of the capital adequacy ratio and liquidity ratios were 0.49631 and 0.38471 respectively, which indicates that, the capital strength and liquidity levels among microfinance banks was satisfactory. The table also indicates that the mean value of assets quality, management quality and earnings quality were 0.130, 12.28, and 0.731 respectively. The skewness and kurtosis values ranged between 1 and 4 which indicated that the assumption of normality was upheld and data was normally distributed.

4.4 Correlation Analysis

Correlation analysis was employed to determine the strength of the relationship among the variables. Table 4.2 shows the results

Table 4.2 Correlation Matrix

	ROA	Financial structure	Capital adequacy	Assets quality	Liquidity	Management quality	Earnings quality
ROA	1						
Financial structure	.217	1					
Capital adequacy	.086	-.227	1				
Assets quality	-.365*	-.063	-.038	1			
Liquidity	.131	-.088	.399**	.133	1		
Management quality	.339*	.285	-.129	-.075	.194	1	
Earnings quality	.190	.951**	-.100	-.121	-.080	.212	1

*. Correlation is significant at the 0.05 level (2-tailed).

**. Correlation is significant at the 0.01 level (2-tailed).

Source: Author 2018

Table 4.2 shows the correlation analysis results, which indicates that there is a weak positive correlation between, return on assets, financial structure, liquidity management quality and earnings quality. The table also indicates that there is a week negative correlation between assets quality and return on assets of microfinance banks in Kenya.

4.5 Regression Analysis

Regression analysis entails the model summary, the analysis of variance (ANOVA) and a summary of the regression coefficients.

4.5.1 Model Summary

The model summary comprises of the R (correlation coefficient), R square (coefficient of determination), the adjusted R square. Standard error of estimate and the Durbin Watson statistics. Table 4.3 indicates the findings

Table 4.3 Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.723[a]	.523	.448	.441787	1.521

a. Predictors: (Constant), Earnings quality, Liquidity, Assets quality, Management quality, Capital adequacy, Financial structure

b. Dependent Variable: ROA

Source: Author 2018

The model summary results on table 4.3 indicate that the R square value is 0.523, which means that 52.3% of the variation in the dependent variable is explained by the independent variables. The other 47.7% is explained by other factors, which the research did not consider, and the error term. The overall correlation coefficient value is 0.723, which indicates that there is a strong correlation between the research variables. The table also indicates that the Durbin Watson statistic is 1.521, which is within the range of 1 to 4 thus an indication that there is no problem of autocorrelation in the data.

4.5.2 Analysis of Variance

Table 4.4 shows the analysis of variance results.

Table 4.4 Analysis of Variance

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	8.132	6	1.355	6.944	.000[b]
	Residual	7.417	38	.195		
	Total	15.548	44			

a. Dependent Variable: ROA

b. Predictors: (Constant), Earnings quality, Liquidity, Assets quality, Management quality, Capital adequacy, Financial structure

Source: Research findings

Table 4.4 indicates that the regression equation is significant as indicated by the F value of 6.994 and the P value of 0.000<0.05. This indicates that the model is fit and a good predictor of the relationship among the research variables.

4.5.3 Regression Coefficients

The regression coefficients results are shown by table 4.5 as follows

Table 4.5 Regression Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	-1.558	.150		-10.376	.000		
	Financial Structure	-.802	.691	-.489	-1.161	.253	.710	1.4045
	Capital adequacy	-.026	.165	-.022	-.157	.876	.660	1.516
	Assets quality	.922	.450	.240	2.048	.047	.920	1.087
	Liquidity	-.781	.326	-.311	-2.396	.022	.743	1.346
	Management Quality	-.015	.004	-.500	-3.751	.000	.807	1.239
	Earnings quality	.354	.199	.725	1.778	.083	.751	1.3315

a. Dependent Variable: ROA

Source: Author 2018

From the results on table 4.5, the following equation was generated.

$$Y = -1.558 - 0.802X_1 - .026X_2 + 0.922X_3 - 0.781X_4 - 0.015X_5 + 0.354X_6 + \mu$$

The generated equation shows that there is an insignificant negative relationship between financial structure, capital adequacy and financial performance of microfinance banks. The results also indicate that there is a significant positive relationship between assets quality and the performance of microfinance banks in financial terms. Additionally, the results indicate that liquidity and management quality has a significant and negative relationship with financial performance of microfinance banks. Finally, the results show that there is an insignificant positive relationship between earnings quality and microfinance banks financial performance. The variance inflation factors (VIF) range between the values of 1 and 10 hence an indication that the variables were not closely related hence there was no multi collinearity.

4.6 Interpretation of the Findings

The research found a significant negative relationship between financial management practices and financial performance of microfinance banks in Kenya. This means that there is a significant relationship between microfinance financial performance and their levels of financial management and also capital adequacy. This finding supports the MFIs financial structure theory, which indicates that the value of the firm does not depend on the financial structure of a firm. However, Olofin and Afangideh (2008) established that there is an inverse significant relationship between capital structure and performance. Omare (2017) also established that debt to asset ratio, total debt and customer deposits affect the performance of microfinance institutions in Kenya. Mbugua (2016) findings established that capital structure (total long term debt to equity ratio) positively affects the financial performance of the Deposit taking microfinance institutions.

The study also found a significant relationship between liquidity, assets quality and management quality and financial performance of microfinance banks. This indicates the microfinance banks financial performance is significantly influenced by liquidity, assets quality and management quality. This finding is similar to that of Ngumo, Kioko and Shikumo (2017) who found a statistically significant relationship between operational efficiency, capital adequacy and financial performance of microfinance banks in Kenya. However, Mburu (2015) established that liquidity and financial leverage depicted negative relationship with profitability. Finally, the study revealed an insignificant positive relationship between earnings quality and microfinance banks financial performance hence an indication that earnings quality does not influence the performance of microfinance banks in financial terms.

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter contains a summary of the findings, the conclusions and recommendations based on the research findings. The chapter also highlights the limitations of the research and suggested areas, which require further review.

5.2 Summary

This study aimed at establishing the effect of financial management on the financial performance of microfinance banks in Kenya. The study explored the contingency theory, the proprietary theory and the residual equity theory were used as the underlying theories for the study. The research carried out a census of the 13 microfinance banks in Kenya as at November 15th 2018 and managed to obtain completed data from 9 microfinances out of the targeted 13. This generated a response rate of 69.23%, which was regarded to be sufficient. Financial management was the independent variable while financial performance was the dependent variable. The CAMEL variables, which included capital adequacy, assets quality, management quality, earning quality and liquidity were incorporated as control variables.

The summary statistics findings established the average return for the microfinance banks was -0.0146 whereas the average debt to assets ratio of the microfinance was 0.179, while the mean value of the capital adequacy ratio and liquidity ratios were 0.49631 and 0.38471 respectively. The results also showed that the mean value of assets quality, management quality and earnings quality were 0.130, 12.28, and 0.731 respectively. The skewness and kurtosis values ranged between 1 and 4 which indicated that the assumption of normality was upheld and data was normally distributed. The correlation results found a weak positive correlation between, return on assets, financial structure, liquidity management quality and earnings quality but a week negative correlation between assets quality and return on assets of microfinance banks in Kenya.

The model summary results indicated that 52.3% of the variation in the dependent variable is explained by the independent variables and overall correlation coefficient value was 0.723, which indicates that there is a strong correlation between the research variables. The regression equation was found significant as indicated by the F value of 6.994 and the P value of 0.000<0.05. A summary of the regression coefficients found an insignificant negative relationship between financial structure, capital adequacy and financial performance of microfinance banks. The research also found a significant positive relationship between assets quality and the performance of microfinance banks in financial terms. The findings further revealed that liquidity and management quality had a significant and negative relationship with financial performance but an insignificant positive relationship between earnings quality and microfinance banks financial performance.

5.3 Conclusions

The findings of the research revealed that the financial management had no significant relationship with microfinance banks financial performance. This research therefore concludes that the financial structure adopted by microfinance banks in Kenya does not influence their performance in financial terms. The study also found an insignificant negative relationship between capital adequacy and microfinance banks financial performance. This research therefore concludes that there is no significant relationship between microfinance financial performance and their capital adequacy. Further, an insignificant relationship between earnings quality and microfinance banks financial performance was found thus the conclusion that earnings quality does not influence the performance of microfinance banks in financial terms.

The findings further found that liquidity significantly affects microfinance banks financial performance thus the conclusion that microfinance banks liquidity levels negatively and significantly affects their performance in financial terms. The research also obtained that management quality has a significant negative relationship with microfinance banks financial performance. As per this finding, the study concludes that microfinance banks financial performance is influenced negatively and significantly by management quality. Finally, the study revealed a significant positive relationship between assets quality microfinance banks financial performance hence the conclusion that assets quality significantly and positively influence the performance of microfinance banks in Kenya.

5.4 Recommendations

The research concluded that the financial structure adopted by microfinance banks in Kenya does not influence their performance in financial terms. The study however recommends that microfinance banks should have an optimal financing mix to ensure that their going concern is assured at all times.

This research concluded that there is no significant relationship between microfinance financial performance and their capital adequacy. Nevertheless, the research recommends that microfinance banks should maintain higher levels of capital since higher capital level relative to its assets ensures the institutions would have sufficient funds of its own to cover the loss.

The study reached the conclusion that earnings quality does not influence the performance of microfinance banks in financial terms. Nonetheless, the study recommends that microfinance banks should ensure they adequately manage their earnings since high earnings are major proxies used to reflect to the longevity of a firm with those institutions with high profitability expected to overcome high competition in the market

In addition, the study concluded that liquidity; assets quality and management efficiency significantly affects microfinance banks financial performance. The study recommends that microfinance banks should have sufficient liquidity, effective management of its loan asset and ensure their operations are managed efficiently to enhance their financial performance.

5.5 Limitations of the Study

The findings of the study are limited to microfinance banks, which are deposit taking, are regulated by the central bank of Kenya, and may not be generalized credit only microfinance’s in Kenya. This is due to the fact that credit only microfinance do not take deposits and their financing model is quite different from microfinance banks which take deposits and meet certain prudential requirements issued by the central bank.

The study also used secondary thus concentrated on quantitative aspects affecting the financial performance of microfinance banks in Kenya. The study also covered the period between January 2012 and December 2016 and during that period, some of the microfinance banks were not in operation, which lead to their exclusion from the targeted population.

5.6 Suggestion for Further Research

The model summary established that financial structure, capital adequacy, assets quality, liquidity, management and earnings quality explain only 52.3% of the variation in financial performance of microfinance banks. The study therefore recommends an additional research on the non-financial factors and other non-qualitative factors that affect the financial performance of microfinance banks in Kenya.

This study focused on microfinance banks only; despite the fact that there are other types of microfinance institutions among them credit only microfinance's, and nongovernmental organization microfinance which also have various sources of financing. The study therefore recommends an analysis of the effect of financial structure on the performance of other forms of microfinance institutions in Kenya.

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APPENDICES

Appendix I: List of Microfinance Banks in Kenya

1. Faulu Kenya
2. Choice Microfinance Bank
3. Kenya Women Microfinance Trust
4. SMEP Microfinance
5. Century Microfinance
6. Uwezo Microfinance
7. Rafiki Microfinance
8. Remu Microfinance Bank Ltd
9. Sumac Microfinance Bank Ltd

10. U&I Microfinance Bank Ltd

11. Caritas Microfinance Bank

12. Daraja Microfinance Bank

13. Maisha Microfinance Bank Ltd

Source: Central Bank of Kenya website (2018)

Appendix II: Data Collection Sheet

MFB Name …………………………………….

Year	2018	2017	2016	2015	2014
Net income					
Total assets					
Borrowings					
Nonperforming loans					
Total loans					
Capital adequacy ratio					
Liquidity ratio					
Total operating					

costs					
Interest income					