

**EFFECTS OF INTERNAL FACTORS ON THE FINANCIAL PERFORMANCE
OF LICENSED DEPOSIT-TAKING MICROFINANCE INSTITUTIONS IN
KENYA**

BY

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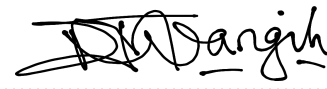
DECLARATION

It is my declaration that this research project is my own research and effort and that it has never been submitted to any learning institution for the completion of any award. I have acknowledged others' information in scenarios in which they have been used.

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

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DEDICATION

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LIST OF ABBREVIATIONS AND ACRONYMS

AMFI-K	The Association of Microfinance Institutions - Kenya
CBK	Central Bank of Kenya
CAR	Capital Adequacy Ratio
CAMEL	Capital adequacy, Asset quality, Management efficiency, Earnings, and Liquidity
DTMFI	Deposit-Taking Microfinance Institutions
IMF	International Monetary Fund
ROA	Return on Assets
ROE	Return on Equity
MFI	Microfinance Institution
NPA	Non-Performing Asset ratio
NPL	Non-Performing Loans ratio

ABSTRACT

This study sought to determine how internal factors affect the financial outcomes of Kenya's licensed deposit-taking microfinance institutions. A descriptive research strategy was used to define the goal. The study's population consisted of 13 Kenyan microfinance institutions licensed by the CBK to take deposits. The study used secondary data that spanned the years 2017 to 2021. The data comprised several variables including return on assets, managerial effectiveness, liquidity, capital sufficiency, asset quality, and firm size, and concentrated on the independent variables and their impact on the dependent variable, financial performance. Both inferential and descriptive statistics were used to analyse the quantitative data that was collected. The R square was 0.612, as was evident from the model summary table. This means that when firm size, asset quality, capital sufficiency, liquidity, and management efficiency were fitted as predictor variables, they were able to account for 61.2% of the overall variation in financial performance. The F-statistic was 21.514 at a threshold of significance of 0.00, according to the ANOVA table. In light of this, the model fit with predictor variables of firm size, managerial efficiency, asset quality, capital sufficiency, and liquidity was statistically fit to forecast financial performance. According to the study's findings, firm size had an increasing effect on financial success. This meant that larger MFIs would outperform smaller MFIs in terms of fiscal performance. Additionally, these findings suggested that MFIs should focus on strategic elements that may affect their growth trajectory and consequently, financial performance. Asset quality was also found to be a positive predictor of financial performance. It was thus noted that the MFIs needed to maintain a portfolio that had more performing loans as compared to the non-performing ones. Financial performance was found to be positively predicted by capital adequacy. These findings indicated how crucial it is for MFIs to keep sizeable capital reserves to protect them from economic downturns. Additionally, it was discovered that liquidity was a good indicator of financial performance. These findings highlight the necessity for MFIs to retain adequate cash so that they can timely and adequately satisfy their financial obligations. Additionally, it was shown that management effectiveness was a good indicator of financial performance. These results demonstrated the importance of having a strong management team at MFIs. In light of the study's conclusions, the research recommends that to maintain high asset quality it is imperative for the MFIs to diversify their loan portfolio to reduce the risks associated with them. It is also recommended that the MFIs put mitigation strategies in place that ensure that performing loans are always more than non-performing loans. The study also recommends that the MFIs regularly check their capital adequacy. This is in a bid to ensure that the MFIs are always in a position to have enough capital reserves that could cushion them from financial strains that could be experienced in the economy. This research also recommends that the MFIs develop rigorous liquidity policies that can test and identify vulnerabilities. In addition, it is recommended that they maintain adequate cash reserves to cover short-term obligations and potential cash flow changes. It is also recommended that management teams of the MFIs embrace technological advancements to help them become more efficient.

CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

Micro-finance establishments play a critical part in the growth of an economy, and their financial performance can have spillover effects on different sectors of the economy (Malakolunthu & Rengasamy, 2012). Factors influencing their performance are essential to understand and prevent economic instability. According to Athanasoglou, Brissimis, and Delis (2018), a successful and stable financial sector can overcome risks and positively impact the financial system's perseverance. Profitability levels and other key drivers determine the strength of the financial system, as internal factors determine the value of assets and investment portfolio, affecting firm success (Morttinen et al., 2015).

This study is guided by the liquidity theory, risk analysis theory, capital adequacy theory as well as the asset quality theory. The Liquidity Theory indicates that the demand for liquidity promotes cash management and success in firms. The Risk Analysis Theory suggests that risk analysis is important to firms before making investing decisions in their operations. Managers must understand the level of risks before making decisions. The Capital Adequacy theory advocates for maintaining a capital level sufficient enough to cushion institutions against unforeseen losses and to ensure business continuity during financial crises, while the asset quality theory emphasizes investing in quality assets to reduce risk exposure whilst generating a steady flow of revenue.

In Kenya, many firms including micro-financial institutions are adopting their internal power to control their success. The financial sector's globalization has resulted in intense competition between conventional banks and micro-financial institutions. Kenya is an

example of a market with a growing micro-financial institutions sector alongside traditional banking. However, there is a need for analysis of how the internal factors can promote the success of licensed deposit-taking micro-financial institutions in Kenya.

1.1.1 Internal Factors

Internal factors are the elements that originate from within the company and directly impact its financial performance. According to Angela and Irina (2015), internal factors are firm characteristics that impact commercial banks, financial performance and might be controlled by management. These aspects differ across institutions and comprise elements such as credit portfolio, labor, ownership, & risk management (Dang, 2011). Internal factors that affect corporate performance can be divided into four major categories, according to Muhammad et al. (2019): strategic elements, structural factors, cultural influences, and operational factors. The formulation of a company's strategy as well as its vision and mission are the strategic elements. The size and complexity of the organization are examples of structural factors. Operational factors are the systems and processes that help the business run, whereas cultural aspects are the organization's values, beliefs, and practices.

The CAMEL framework is employed to assess internal factors and evaluate the operational and financial performance as well as legal compliance of financial institutions. According to the CAMEL paradigm, internal factors influencing the financial performance of financial institutions include: capital sufficiency, asset quality, managerial efficacy, earnings, and liquidity. In 1996, Sensitivity to market risk was added as a sixth component, to make the rating structure more risk-oriented (Kamande, 2017). Other internal factors that are commonly considered take into account financial possessions such as asset

opportunities and subsidies, physical properties such as equipment, branch locations and facilities, and human resources i.e. employees, intellectual and social capital.

1.1.2 Financial Performance

Financial performance alludes to the capacity of An establishment to generate earnings and increase its investor's wealth. Financial performance, according to Borman and Schmit (2015), is a multidimensional paradigm built on the analysis of several aspects. Financial performance, according to Aguinis and Kraiger (2012), is the accomplishment of a company's purpose, vision, and financial objectives, as measured by quality of service and customer happiness, which translates to growing profitability; it is evaluated using the level of impartiality return and assets return. Also, financial performance, according to Koontz and Donnell (2010) is a firm's ability to achieve core objectives such as increased return on investment and profit. A bank's financial performance must be strong to ensure long-term viability while also increasing shareholder value.

The excellent financial performance of a bank indicates that its management is able to pay off its obligations while also maintaining a surplus that can be distributed to shareholders or used to fund future investments (Brissmis & Delis, 2005). As a result, the economic ramifications of a bank extend far beyond the bank's own economy. Bank profitability, according to Sufian and Habibullah (2010), is a critical component of financial growth, not only for the commercial bank in question but also for macroeconomic stability. Greater returns reduce loan fragility at the firm level while increasing global profitability, resulting in a strong banking industry that can expand and develop financially.

According to Capital Markets Authority (2022), firm financial performance is based on the profits achieved and the total value of sales. Other important measures of financial performance in a firm include the market portion, Assets' return (ROA) as well as Equity return (ROE) (Liu & Wilson, 2010). However, the IMF argued that managers can gauge the success of companies' financial performance based on the return on investments, the value of assets, and number of deposits. Mokhtar et al. (2014) also confirm that total assets, sales volume as well as profitability are factors that indicate the financial value of the firm.

1.1.3 Internal Factors and Financial Performance

Given the variety of variables that might affect a firm's financial health, the connection linking internal factors and the financial health of the firm can be complex and multifaceted. Capital adequacy enables a firm to fulfil its long-term financial commitments. A corporation with a high level of capital adequacy will have enough capital to cover all of its immediate and future financial obligations. This can be crucial for a company's financial performance as it can guarantee that the company is secure financially and prepared to withstand economic crises. On the other hand, a firm can fulfil its short-term financial obligations thanks to liquidity. A firm is said to have high liquidity if it has enough cash and other liquid assets to pay all of its immediate liabilities. Liquidity is therefore vital for financial performance because it can ensure that the business keeps running and invests in expansion opportunities (Mokhtar et al., 2014).

Asset quality of an organization also impacts financial performance in that, the earnings of a firm can be greater if it has high-quality assets that can provide scaled-up revenue hence higher profits. A financial institution's loan portfolio's quality and possibility of repayment

are referred to as its asset quality. The monetary presentation of an organization can be influenced by a firm's size as well. Bigger businesses may have more access to resources and benefit from economies of scale, which can boost sales and profitability. Lastly, managerial effectiveness can affect an organization's financial performance because it can help to enhance operations, cut expenses, and spur revenue growth.

Empirically, a variety of studies have looked into the connection linking internal factors and business performance, with most studies suggesting a noteworthy positive connection between internal aspects and the financial outcomes of financial institutions. For instance, Chen and Lin's (2016) study discovered that age and ownership concentration had a noteworthy contrary outcome on financial performance, while company size, liquidity, and leverage have a significant positive/direct effect. Additionally, a revision by Nguyen and Nguyen (2019) established that capital adequacy has an affirmative control over the financial results of banking institutions and that this effect is mediated by the quality of their assets. The study also discovered that managerial effectiveness affects banks' financial performance positively and that this effect is mediated by both adequate capital and high-quality assets. Similar findings were made by Thao and Le (2020), who discovered that the financial outcomes for Vietnamese commercial banking institutions were significantly and positively influenced by asset quality. The research also discovered that asset quality serves as a mediator between capital sufficiency and operational efficiency on the earnings performance of banks.

This research suggests a positive link between liquidity, capital adequacy, firm size, asset quality, and management competence on financial performance (Liu & Wilson, 2010).

Firms that have higher levels of liquidity, capital adequacy, asset quality, larger size, and more efficient management typically have better financial performance. However, the strength of the relationship may differ based on the specific context of the firm and the industry in which it operates.

1.1.4 Microfinance Institutions in Kenya

In Kenya, there has been a significant rise in the number of microfinance banks since the mid-1990s, accompanied by the establishment of regulatory bodies to oversee them. The objective of these changes is to improve customer experience and make these institutions the preferred lending option for Kenyans. Due to the high demand for credit in the country, a competitive financial industry has emerged with various microfinance banks offering unique services to stand out (Aswani, 2018).

The microfinance industry in Kenya is robust and comprises various institutional forms with a significant branch network serving economically active low-income earners. This sector includes microfinance banks regulated by the Central Bank of Kenya (CBK), church-based microfinance institutions, NGOs, and different types of savings and credit associations (Aswani, 2018). The Association of Microfinance Institutions - Kenya (AMFI-K) serves as the industry's overarching body.

The Microfinance Act of 2006 was designed to find a suitable regulatory and legal framework for the microfinance industry, ensuring a level playing field. Microfinance institutions in Kenya can be broadly classified into commercial banks, regulated MFIs, and unregulated MFIs (Warue, 2015). Deposit-taking microfinance institutions and microfinance banks are regulated by the CBK to promote access, efficiency, and competition,

while non-deposit-taking MFIs are classified as credit-only entities and are not regulated by the CBK (Nyakinda, 2019). Currently, 13 licensed microfinance banks are operating in Kenya.

1.2 Research Problem

Internal factors influence the success of firms across the globe. One of the main challenges facing poor households is the lack of capital, which prevents them from breaking free from persistent poverty. Microfinance institutions aim to break this cycle by providing access to capital and unlocking household labor. However, these institutions face numerous challenges, both externally and internally, that could lead to unpredictability. With effective internal factors management, firms can enjoy high growth. However, this requires a number of conditions to be put in place.

In Kenya, Microfinance institutions face several challenges such as methodological flaws, uncontrolled growth, fraud, bureaucracy, and financial instability. The microfinance institutions, most times, charge high-interest rates which in turn reduces the number of customers, many of whom are economically marginalized people meant to benefit from these institutions and end up not finding the financial freedom they need (Aswani, 2018). The MFIs seem to have lost sight of their role in addressing the needs of marginalized people by providing affordable credit services. This means that there is a need to determine how internal aspects impact the financial presentation of Microfinance Institutions in Kenya.

Daher and Le-Saout (2015) undertook research in France to explore the influence that the global financial crisis had on microfinance institutions' performance, as well as to identify

the determinants of their financial results. The revision indicated a substantial statistical correlation amid the recent global economic crisis and the deterioration in MFIs' profitability. In conclusion, the study noted that the most capitalized MFIs stand to be the most profitable during global financial crises. However, the study was done outside Kenya. Saad, Taib, and Bhuiyan (2017), conducted a study in Pakistan to find out the factors that affected the outreach performance of microfinance institutions. The figures were mainly collected from the twelve-monthly financial news of these institutions. The findings included firm size, profitability, and return on asset positively affecting the breadth and depth of the MFIs' outreach performance, while over 30 days portfolio at risk negatively affects the breadth of the MFIs' outreach performance. However, the research utilized existing data sources.

Wijesiri, Viganò, and Meoli (2015) researched the impact of internal factors such as social capital, structure, and customers on the performance of MFIs. The study gathered data from 145 managers of various MFIs in Sri Lanka using a cross-sectional survey design. The study found that customer base, capital adequacy, and structure positively influenced the institutions' financial performance, but human and social capital had no impact on the MFIs' performance. However, this study was based on structural design and analysis.

In Kenya, Peter Muthomi Muguongo (2016) undertook elaborate empirical research on a number of selected internal business factors and how they affect the growth and development of micro-finance institutions in Kenya. Muguongo et al. (2016) utilized descriptive research to examine the behavior of variables and a multiple regression model to investigate the connection linking microfinance institutions' expansion and chosen internal factors. The analysis findings indicated that internal factors promote firm growth.

However, the study was based on a non-linear model. Abraham Yaak Diar, Gladys Rotich, and Andrew Ndege Ndambiri (2017) also conducted an experiential study in 2017, examining the factors impacting the expansion of microfinance institutions operating in Kenya. The trio mainly focused their study on the microfinance institutions operating in the capital, Nairobi. They used descriptive research design and the study concluded that MFIs should leverage financial literacy as a means of promoting continuous economic growth. However, the study was done in 2017 and things have changed.

Based on the above studies, there is a contextual difference in how internal factors affect firm growth. The majority of studies also used descriptive models and other studies show the use of correlation as well as multi-variant simple analysis. The controversies in the findings birth a question that begs for an answer: How do internal factors affect the performance of finance on licensed microfinance institutions in Kenya?

1.3 Research Objective

This research study aimed to assess how internal factors influence the financial outcomes of licensed deposit-taking microfinance establishments in Kenya.

1.4 Value of the Study

This research study might benefit different practitioners in Kenya, for instance, top managers of micro-finance establishments. The management of the firms would learn how they can use internal factors to promote the financial performance, growth, and success of their firms. Additionally, the study would emphasize the significance of internal factors in enhancing the financial performance of MFIs, which is crucial for the firm's long-term growth.

The study would provide policymakers with fresh insights into the connection linking internal aspects and financial outcomes of microfinance institutions in Kenya, enabling them to develop relevant policies to enhance their effectiveness. Ultimately, this would contribute to promoting MFIs' financial performance in the country.

This study would add to the assemblage of information on the connection linking internal factors and the commercial performance of MFIs, providing insights that other scholars can use as a reference point for future studies. It would emphasize the significance of internal factors in promoting financial performance and increase awareness among scholars about their importance in this context.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This section presented a look back at past research on the effect of internal aspects on firms' financial success, providing a background on the topic. The chapter also discussed the theoretical framework, knowledge gaps, and experimental investigations.

2.2 Theoretical Framework

The hypothetical framework gives the study a conceptual foundation. It is a collection of theories, definitions, and concepts that work together to describe the research challenge and direct the investigation. Overall, the theoretical underpinnings of this study served as a basis for understanding the major ideas, variables, and connections that were investigated in our revision on the power of internal variables on the financial presentation of licensed microfinance deposit-taking establishments in Kenya. Liquidity theory, risk analysis theory, capital adequacy theory, and asset quality theory guide this research.

2.2.1 Liquidity Theory

Keynes (1936) developed this theory and it indicates that the demand for liquidity promotes cash management and success in firms. This is because liquid assets are simpler to sell for their full worth. This theory supports the view that the need for liquidity has speculative power.

The theory assumes that individuals appreciate money for both its usage as a store of wealth and present commercial transactions. When interest rates are low, individuals tend to keep more cash on hand to ensure financial security, forgoing the opportunity to earn interest on that money. However, when interest rates rise, people are more likely to invest their money

to generate profits. It is important to keep some money in a liquid form for future uncertainty, to make predictions about interest rates, and to fund future expenses (Elgar, 1999) Precautionary, speculative, and transactional motives are terms used to describe these reasons for requesting money.

One of the strengths of this theory is that it indicates the levels of cash transactions in a company and how this promotes liquidity and performance of the firm (Liu & Wilson, 2010). However, this theory focuses too much on income and liquidity ignoring other important factors of firm performance. The theory puts more preference on cash at hand than other factors that promote investment opportunities and success in companies (Laeven & Levine, 2009).

This theory was relevant to this review because it is frequently used in previous empirical studies to explain why firms prefer to hold cash. In this review, the applicable variable for this theory is liquidity. The theory explains how firms can use cash in their internal operations to promote high growth. This theory shows the importance of using cash transactions in promoting investment and productivity in terms of finance in the firm, thus, it is relevant to the study.

2.2.2 The Risk Analysis Theory

According to Hawley (1893), the most critical role of an entrepreneur is to take risks, and by doing so, they receive profits as a reward for exposing their business to risk. This theory indicates that risk analysis is important to firms before making investing decisions in their operations. It is commonly believed that investments in risky ventures must yield returns greater than the risks involved and that more risky ventures yield higher profits. However,

Damodaran (2018) argues that senseless risk-taking does not result in higher rewards, and markets do not reward firms more for taking more risks. He points out that profit is not necessarily correlated with the level of risk taken, and that engaging in high-risk ventures may not always result in high profits. Therefore, it is incorrect to assume that markets reward all risk-taking, as it is the quality of risk-taking that determines the rewards.

One of the advantages of this theory is that it supports risk analysis. It helps firms to avoid risky investments. This theory overlooks other factors that contribute to profits and focuses solely on risks. In this study, the theory is relevant since it supports the idea that a firm's risk on returns directly affects a company's future and ability to continue operating. Managers should build an internal optimum capital structure that accomplishes an optimal risk-return trade-off that promotes the bank's fiscal performance. It also supports the need for risk analysis in all investment activities in firms.

2.2.3 Capital Buffer Theory

The extra capital that a financial institution keeps over the minimum required capital is known as the capital buffer. According to the capital buffer theory by Holmström and Tirole (1998), banks aim to keep regulatory capital as insurance above the regulatory minimum contrary to failure to meet the regulatory least possible capital obligation. The theory of buffer of capital assesses the amount of resources that a financial institution should hold to meet its obligations and withstand financial stress. The theory applies mainly to banks and financial institutions, and its purpose is to ensure that these institutions maintain adequate capital to withstand unforeseen losses and operate during economic turmoil. The capital buffer theory is founded on the idea that a bank's capital functions as a safeguard against unforeseen losses. Here, a bank's capital is calculated as the disparity

between its assets and liabilities, and it seeks to guarantee that banks maintain enough capital levels to endure unexpected losses as well as to sustain operations during periods of economic strain.

Regulators utilize a Capital Adequacy Ratio (CAR) to establish the appropriate level of capital a bank should maintain. This proportion estimates a bank's capital against its risk-weighted resources, with a higher CAR indicating greater capital relative to risk-weighted assets and increased resilience to economic pressure. The CAR is determined by dividing a bank's capital by its risk-weighted resources. Regulators set minimum CARs for financial institutions to ensure that they are adequately capitalized. In addition, some banks may choose to hold more capital than the minimum requirement to provide an additional buffer against unexpected losses.

Capital buffer theory is an important concept in the finance industry as it helps to ensure the soundness and stability of financial institutions. By requiring banks to hold sufficient capital, regulators can help prevent bank failures and protect depositors and other creditors from losses. The theory can help test how capital adequacy as an internal factor promotes firm success.

2.2.4 Asset Quality Theory

The asset quality theory is a financial concept that assesses the assets of financial institutions, including credit unions and banks, to determine their quality. The majority of bankruptcy scholars concur that a significant number of bad debts be present before a monetary establishment can be deemed insolvent, seeing as asset worth is a leading indicator for the liquidation of financial institutions (Demirguc-Kunt, 1989) and (Whalen,

1991) The theory emphasizes that the quality of assets is a crucial aspect of evaluating the financial well-being of a financial institution, which is significant in handling company issues.

The theory assumes that the quality of assets is determined by several factors, including the creditworthiness of borrowers, the value of collateral, and the economic conditions in the market. Assets that are deemed to be of high quality are those that are expected to generate a reliable stream of income and maintain their value over time. These assets are considered to be less risky and more valuable to the financial institution. The model also supports the view assets that are of low quality are those that are expected to generate less reliable income or lose value over time. These assets are considered to be riskier and less valuable to the financial institution. They can also be more difficult to sell or collect, which can create financial challenges for the institution.

Asset quality theory is vital in this research since it helps financial institutions manage risk and make informed decisions about lending and investment activities. By assessing the quality of assets, institutions can identify potential risks and take steps to mitigate them, which can help to ensure their long-term financial stability. The model can help test how assets can promote the success of firms.

2.3 Determinants of Financial Performance of Micro Finance Institutions

Organizations can utilize various factors to their benefit, as noted by Ongore and Kusa (2013), including the size and composition of their management proficiency, location, liquidity, deposit size, risk level, asset quality, earnings potential, labor productivity, and

credit portfolio (Dang, 2011). Scholars and industry practitioners frequently employ the CAMEL framework to assess internal bank factors.

2.3.1 Internal Factors

Capital adequacy alludes to the funds accessible to a bank that serve as a buffer during unfavorable circumstances. According to Athanasoglou et al. (2005), capital provides banks with additional liquidity since deposits are susceptible to bank runs. The higher the level of capital a bank maintains, the less likely it is to experience distress. Dang (2011) suggests that a bank's capital effectiveness is determined by its capital adequacy ratio.

The profitability of a financial institution is influenced by its assets, which include fixed assets like buildings, credit portfolios, current assets, and other investments. The most significant risk a commercial bank faces is non-performing loans when customers default on their loans. A bank's profitability is directly impacted by the calibre of its loan portfolio. Therefore, Non-Performing Loan Ratios (NPLs) are used to assess the asset quality of a bank. Commercial banks strive to keep NPL levels as low as possible because having high NPL levels hurts their capacity to make a profit.

Assessing management efficiency through financial ratios is a challenging task, as it involves evaluating qualitative factors such as the quality of staff, organizational discipline, and control systems (Ongore & Kusa, 2013). The efficiency of a management team can be measured using financial ratios that calculate their ability to effectively use available resources to minimize operating costs and maximize income. The operational-profit-to-income ratio is a statistic used to determine management quality, with a higher ratio indicating efficient management in terms of operations and generation of revenue. The

level of operating expenses, which impacts profitability, is determined by management quality (Athanasoglou et al., 2008).

Liquidity refers to the ability of an institution to meet its transient commitments and is a crucial element in determining bank representation (Dang, 2011). Passable liquidity certainly impacts bank profitability. Financial ratios such as the customer-deposit-to-total assets ratio, and total-loans-to-customer-deposits ratio are commonly used to measure liquidity. The cash-to-deposit ratio is also used in Malaysia. However, a revision done in China and Malaysia displayed no significant association linking liquidity levels and bank performance (Said & Tumin, 2011)

The firm size and its performance is a complex relationship, as there are several factors that can influence performance. Generally speaking, larger firms tend to have certain advantages over smaller firms, but there are also potential drawbacks to being a large firm. Larger businesses benefit from economies of scale, according to analysis. Larger businesses can benefit from economies of scale, which means that as production levels rise, so does the cost of generating each unit of output. This can lead to lower costs and higher profits. There is also access to resources and larger firms may have access to more resources, such as capital, technology, and human resources, which are utilized to improve their financial performance.

2.3.2 External Factors

Firm performance can be affected by a broad range of external elements, including economic conditions. The state of the economy can have a critical influence on a firm's performance. In a recession or downturn, demand for goods and services may decrease,

making it more challenge for firms to generate revenue and profits. Analysis also indicates that market competition influences firm performance. The level of competition in a particular industry or market can affect a firm's performance. More competition can make it harder to differentiate products and services and maintain market share.

Other external factors include technological innovation and advances in technology can create opportunities for firms to further develop productivity, diminish cost, and make new services and products. However, failing to keep up with new technologies can lead to a competitive disadvantage. There are also government regulations and laws and regulations can have a huge effect on a firm's profitability and operations. Regulatory changes can affect costs, pricing, and market access.

Other factors include social and cultural trends. Social and cultural trends can influence consumer behavior, leading to changes in demand for certain products and services. Firms that are not responsive to changing consumer preferences may struggle to maintain market share. In most cases, external factors can have a huge effect on firm performance, and firms must be aware of these factors and adapt to them to maintain a competitive advantage.

2.4 Empirical Literature Review and Research Gaps

Daher and Le-Saout (2015) undertook a study on the monetary performance of MFIs and the effect of the worldwide financial meltdown on their profitability. They gathered data from various sources such as Mix Market, World Development Indicators, Bloomberg, and the Heritage Foundation database. They analyzed the data using multiple regression models and found that the global financial crisis proved a negative result on the cost-effectiveness of MFIs. In conclusion, the review noticed that the most capitalized MFIs stand to be the

most profitable during a global financial crisis. However, the study's failure to utilize primary data made it vulnerable to using inaccurate and manipulated data, leading to wrong findings and conclusions.

In Pakistan, Saad, Taib, and Bhuiyan (2017) conducted a research study to assess the dynamics upsetting the outreach performance of MFIs in Pakistan. They collected data from the annual reports of these institutions and obtained an unbalanced panel data sample of 37 MFIs operating in Pakistan from 2011 to 2015, which included 162 observations. The collected data was subjected to random effect regression analysis. The findings concluded that return on asset, profitability, and firm size positively affect the breadth and depth of the MFIs' outreach performance; while over 30 days portfolio at risk negatively affects the breadth of the MFIs' outreach performance. Despite analyzing the operating expense ratio, the authors did not find a noteworthy impression on the outreach representation of microfinance institutions (MFIs) in Pakistan. However, they found that profitable MFIs should reinvest their earnings to reach a maximum number of less fortunate individuals and expand their loan portfolio. Despite using both primary and secondary data, the study failed to effectively outline its research methodology, making it difficult to establish how the study was conducted and the findings and conclusions reached.

In Sri Lanka, Wijesiri, Viganò, and Meoli (2015) conducted a study to determine how different dimensions of Intellectual Capital (IC) affect the performance of microfinance institutions (MFIs), specifically customers, structure, human, and social capital. They used a cross-sectional survey design to extract data from 145 managers of various MFIs in Sri Lanka, which they scrutinized via Partial Least Square Structural Equation Modeling (PLS-SEM). Their revision found that operational and customer capital had an affirmative

influence on the pecuniary representation of the institutions, while human and social capital had no weighty influence on the MFIs' performance. Nonetheless, the fact that less than 50% of the MFIs' managers across the country participated in the study makes it limited and less comprehensive.

In Kinshasa, DRC, Tuema (2018) did a review to investigate the issues that impact the monetary performance of MFIs in Kinshasa, DRC. The review utilized a descriptive correlational study plan, with a focus on three research questions. Data was collected from 100 credit officers of MFIs in different departments using structured surveys, and the collected facts were evaluated by descriptive and inferential statistics. After scrutiny, the review discovered that the firm's competition, strong customer relationships, and reduced cost in providing loans significantly affected the MFIs' performance in terms of profit margin. In the end, the study established that regulations are critical to MFIs' financial performance, significantly affecting their performance. Nonetheless, the study failed to establish more precise and conclusive findings.

Ashenafi and Kingawa (2015) conducted a study on the aspects that influenced the financial lucrativeness of microfinance institutions (MFIs) in the Southern Nation's Nationalities People's Regional State in Abuja (SNNPRS) from 2009 to 2013. The study primarily collected data from secondary documents and financial statements of selected institutions. The derived figure was scrutinized using Multiple Linear Regression models and descriptive statistics for the three MFIs. In the findings, the analysis proved a statistically significant positive co-efficient linking the age of the MFIs and their profitability and economic growth. In the end, the duo concluded that MFIs should find ways to reduce their firms' operational costs and implement better credit management

policies. However, the study largely depended on secondary data that might have been inaccurate; making the findings vulnerable and potentially invalid.

Ertiro and Mohammed (2019) conducted a study to identify the key factors that impact the financial performance of MFIs in Ethiopia. The revision utilized panel data collected from 17 out of the 31 MFIs operating in Ethiopia between 2011 and 2018. The statistics were scrutinized utilizing regression analysis; therefore, the outcomes indicated that the earnings of the MFIs were negatively affected by internal variables like capital-to-asset and debt-to-equity ratio. However, the size of microfinance institutions, portfolio quality, and operational efficiency were discovered to have a direct impact on their fiscal representation. The review concluded that MFIs should focus on developing effective campaigns to mobilize savings from members and operate on membership contributions to avoid unexpected losses and ensure efficient operations each year. However, the study depended on only one source of information, limiting diversity and accuracy.

Muguongo (2018) conducted a study that aimed to investigate how selected internal business factors affect the growth and development of MFIs in Kenya. To accomplish this, the author used a descriptive inquiry plan and collected secondary figures for the previous decade from 13 licensed microfinance institutions. The study analyzed data on features like; liquidity, economic growth, money capability, operational cost efficiency, and asset quality using STATA and presented the findings in tables. Muguongo utilized a multiple regression model to examine the relationship between microfinance institution growth and the selected internal factors. According to the descriptive statistics, the mean growth for the thirteen selected MFIs over the past decade was 0.06467 with 0.365 as the maximum growth and -0.327 as the minimum growth. The growth's standard deviation was 0.13153,

indicating a narrow growth spread from the average growth. The STATA software revealed an average capital adequacy of 0.35445, average operational cost efficiency of 0.0017, and liquidity ratio of 0.82531 for the thirteen institutions over the last ten years. The analysis also involved various diagnostics tests, including normality, multicollinearity, and Heteroscedasticity tests. Other analyses involved in analyzing different aspects and variables of the study include correlational analysis and regression analysis. The analysis findings were compared to different authors' assertions with most findings confirming the authors' assertions. The study further made specific recommendations for each factor, recommending that the MFIs' management should improve their assets' investment levels and quality by increasing the controlling, monitoring, measurement, and risk identification of the rate of non-performing loans. It also recommended the widening of the MFIs' capital base, facilitation of increased liquidity, and use of cutting-edge technology and creative operational approaches. However, the study primarily used secondary data, to which the researcher was not privy on how it was collected as well as their accuracy and validity. Additionally, the study largely involved scientific research analysis methods, making it challenging to obtain qualitative information that would have enlightened the discreet problems surrounding the association between the MFIs' growth and the selected internal factors, making the study less comprehensive.

Diar, Rotich, and Ndambiri (2017) conducted a revision to recognize the aspects disturbing the growth of microfinance institutions in Nairobi, Kenya. They collected data from 36 staff representatives of MFIs using questionnaires and analyzed it using SPSS and multiple regression analysis. The study established that fiscal literateness and leverage have an affirmative and significant relationship with the development of MFIs. Therefore, the

research settled that MFIs should promote pecuniary literacy to support their economic growth. However, the study's scope was limited as it focused on Nairobi only yet there are numerous MFIs across Kenya.

Ngumo, Collins, and David (2020) conducted a review of the factors affecting the fiscal results of Microfinance banks in Kenya. The review utilized secondary facts from seven selected MFIs and employed reversion and correlation analysis. The findings revealed a substantial progressive affiliation between operational efficiency, money suitability, the size of the company, and the fiscal results of MFIs. However, there was an insignificant negative connection linking financial performance and liquidity and credit risks. The investigation concluded that there exists a direct association linking the sufficiency of capital, operative effectiveness, size of the firm, and financial performance of MFIs in Kenya. Nonetheless, the review only utilized secondary figures, which might have been inaccurate and misleading.

In Kenya, Muithya and Muathe (2020) conducted an exploratory study on the association linking dynamic potential and representation in Kenya's microfinance institutions. The study analyzed data from 13 licensed MFIs in Kenya from 2017 to 2018 using both primary and secondary sources. Multiple regression analysis was employed to regulate the statistical significance of the findings. The revision discovered that licensed MFIs serve a pertinent part in Kenya's economic growth by offering financial services to the needy and underserved. However, these institutions faced challenges such as financial sustainability policies, funding, government regulations, market sustainability, and repayment default. Overall, the licensed MFIs experienced a decline in assets in 2017, which was contrary to the growth witnessed in 2016. However, this study was performed on all performance

measures and not only financial performance. In addition, the study focused mainly on how dynamic capabilities affect firm performance.

2.5 Conceptual Framework

This framework illustrates how the predictor variables (internal factors) are linked to the dependent variable (financial performance) in the study. This is presented in Figure 1 below.

Independent Variables

Dependent Variable

Internal Factors

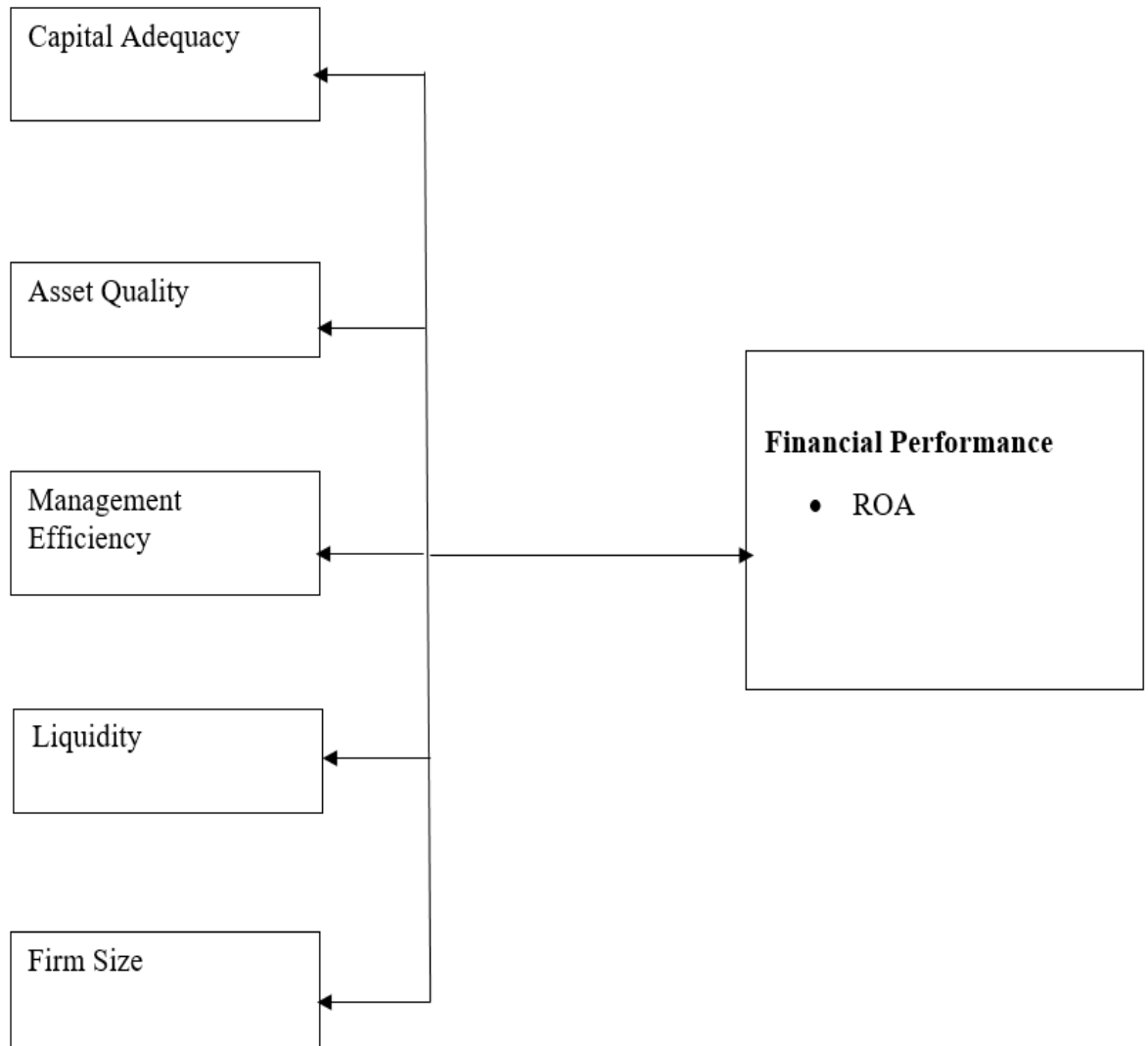


Figure 1: Conceptual Framework

Source: Author, (2023)

2.6 Summary of Literature Review

From the review of past research, internal factors promote the growth of firms. Despite this, many of the studies are based on Western books and publications. In addition, there are conceptual, contextual, and methodological gaps that need further studies. The analysis confirms that many studies focus on the banking and manufacturing industry ignoring the micro-finance level. This leaves conceptual gaps and many of the past studies are based on mixed methodology in their analysis leaving methodological gaps that need further studies.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This section describes the methodologies used in this study to address the research topic and the relevant exploration strategies. This comprises the research design, study population, and information collection techniques,. The techniques for data analysis that were used to examine the study's conclusions following data collecting were also included in the chapter. Tests for dependability and data validity were also included.

3.2 Research Design

This section is important in all studies since it depicts the plan of the study. This study adopted quantitative research to achieve the objective. The integration of the descriptive models promoted the gaining of further insights into the topic of the study. The researcher created a profile of qualified deposit-taking Microfinance Institutions in Kenya.

Creswell (2017) defines a study design as a combination of strategies one uses to solve a research problem. The study strategy for this review was a descriptive research strategy. This helped to depict and describe how internal factors affect fiscal performance.

3.3 Population of the Study

The objective populace is the group that the researcher intends to gather data from. The target group can be used to generalize the study results (Kothari, 2012). Some argue that 10-30% of the group is reliable to gather data (Mugenda & Mugenda, 2003). The target group helps to gain data based on their distribution and number. In this study, the target group was the authorized deposit-taking Microfinance Establishments in Kenya. The researcher focused on all the approved deposit-taking Microfinance Establishments in

Kenya, which are thirteen according to the Directory of Licensed Microfinance Banks (2020). As such, this was a census research.

3.4 Data Collection

In this study, information was collected using inferior methods. This means that data was gained from printed audited financial statements of the microfinance institutions, website data, and peer-reviewed journal articles associated with the topic of the study. The data focused on the 13 Licensed Microfinance Banks (CBK, 2020). The data collected covered a 5-year period from 2017 to 2021. The data focused on the independent variables and their influence on the dependent variable, financial performance, and covered factors such as return on assets, management efficiency, liquidity, capital adequacy, asset quality, and firm size.

3.5 Data Analysis

The study used quantitative data, which involves numbers, and analyzed it utilizing both descriptive and inferential statistics. Descriptive statistics included standard deviation, mean, and frequencies and were presented using tables, and percentages. The study also used inferential statistics to cover standard deviation, median, and mean, and a multiple linear regression model was utilized.

3.5.1 Diagnostic Tests

The study conducted a normalcy test, the Shapiro-Wilk test, to evaluate if the data follows a normal distribution and to determine the likelihood of the underlying random variable naturally conforming to the distribution. The study also tested for multi-collinearity using the Variance Inflation Factor (VIF) test to measure the degree of correlation between each

predictor variable and all other predictor variables in the model. If collinearity is discovered in the data, regularization techniques like ridge regression shall be applied to lessen the effect of collinearity on the model.

To test for heteroscedasticity, the Breusch-Pagan Lagrange/Multiplier (LM) Test was used to determine the relationship between the squared residuals and the independent variables. If heteroscedasticity is found in the panel data, the weighted least squares method, which involves weighing the observations in the regression model to provide more weight to observations with smaller variances, was employed.

The test of specification was conducted through Ramsey RESET Test. This test is designed to determine whether the model has specification problems, specifically whether any variables have been omitted or the functional form has been incorrectly specified. Lastly, the research also included a test for serial correlation, the Durbin-Watson test, which was useful in determining whether the model's error term exhibits autocorrelation. If autocorrelation is detected, the standard errors in the model would be adjusted using robust estimators to account for serial correlation in the error terms.

3.5.2 Analytical Model

The study utilized an analytical model to present the findings clearly and directly. Panel data analysis was employed since data was collected on various variables from several firms over several years. The Social Science Statistical Software Analytical Package (SPSS) was used for the multiple linear/regression analysis. The regression analysis is illustrated below:

$$Y = a + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \varepsilon$$

Where:

Y = Financial Performance

X₁ = Capital Adequacy

X₂ = Asset Quality

X₃ = Management Efficiency

X₄ = Liquidity

X₅ = Firm Size

a = constant term

β₁, β₂, β₃, ... = Beta coefficients

ε = Error term

The variables was measured as shown in the table below:

Variable	Measure	Formula
Financial Performance	Return on Assets (R.O.A)	$R.O.A = \frac{\text{Net Profit}}{\text{Total Assets}}$
Capital Adequacy	Capital Adequacy Ratio (C.A.R)	$C.A.R = \frac{\text{Total Capital}}{\text{Risk Weighted Assets}}$
Asset Quality	Non-Performing Asset Ratio (N.P.A)	$NPA = \frac{\text{Total non performing loans}}{\text{Total loans outstanding}}$
Management Efficiency	Operational Self-Sufficiency Ratio (O.S.S)	$OSS = \frac{\text{Operating revenue}}{\text{Operating expenses}}$
Liquidity	Current ratio (C.R)	$C.R = \frac{\text{Total current assets}}{\text{Total current liabilities}}$
Firm Size	Value of Total Assets	Size = Natural log of Total assets

3.5.3 Tests of Significance

Tests of significance determine whether the regression analysis results are statistically significant, i.e., whether the associations amid the independent and dependent variables are real or merely coincidental, as well as the model's overall significance. To test for the model's significance, the study utilized F-tests and T-tests to demonstrate the effectiveness of the linear regression model, particularly when compared to a model without independent variables. The F-test was particularly useful in highlighting the superiority of the linear regression model as it determines the overall significance of a regression model. It tests

whether at least one of the coefficients in the model is statistically significant. On the other hand, the T-tests showed the mean variations in the regression model to determine if individual coefficients are statistically different from zero.

CHAPTER FOUR: DATA ANALYSIS RESULTS AND DISCUSSION

4.1 Introduction

This research was carried out with the motive of assessing how internal factors influence the financial performance of MFIs licensed to take deposits in Kenya. This study investigated in detail firm size, capital sufficiency, liquidity, asset-quality, and management efficiency, and how they affected financial performance.

By placing a focus on descriptive statistics, diagnostic tests, regression analysis, and a discussion of the findings, this chapter offers the results of data analysis and interpretations. The five-year period from 2017 to 2021 was the focus of the investigation.

4.2 Response Rate

The study made use of secondary data gathered from audited financial statements and the websites of microfinance organizations. All the 13 Licensed Microfinance Banks, who were the study's target population, provided comprehensive information to the study. Thus the study achieved a 100% response rate. Hence according to Mugenda and Mugenda (2003), the data was excellent for analysis, interpretation, and inference.

4.3 Descriptive Statistics

The study made use of descriptive statistics to summarize the properties of the information in a meaningful way. Mean, standard deviation (SD), minimum, and maximum were some of the descriptive statistics investigated. Mean displayed the data points' average. The SD examines the data's variability and explains how far the data points deviate from the mean.

Minimum displays the data set's lowest point, whereas maximum displays the data set's highest point. The research's outcomes are illustrated in the below table:

Table 4.1: Descriptive Statistics

	Minimum	Maximum	Mean	Standard Deviation	CV%	Skewness	Kurtosis
Capital Adequacy	0.0562	0.473	0.186606	0.0648056	34.72857	2.326356	8.567343
Asset Quality Management efficiency	0.0014	4.1096	0.252645	0.5242888	207.52	1.295505	0.715613
Liquidity	0.0054	2.7132	0.905742	0.65847	72.69951	0.040297	-0.64927
Firm Size	0.0911	2.3156	0.446568	0.3217131	72.04123	0.675973	-0.65506
Financial Performance	17.6198	24.1447	20.99961	1.8262121	8.696409	0.328522	-0.72782
	-0.61034	0.0530	-0.11868	0.163756631	-137.982	-1.36483	0.8744

Source: (Secondary Data, 2023)

Table 4.1 shows that capital adequacy had a mean of 0.186606 and SD of 0.0648056. Asset-quality presented a mean of 0.252645 and SD of 0.5242888. Management efficiency on the other hand, produced an average of 0.905742 and SD of 0.6584870. Liquidity provided a mean of 0.446568 and SD of 0.3217131. Firm size presented a mean of 20.999611 and SD of 1.8262121. Financial performance had an average of -0.11868 and a SD of 0.163756631.

The coefficient of variation showed that asset quality data exhibited the greatest dispersion level around the mean while financial performance displayed the least dispersion of data points around its mean.

4.4 Diagnostic Tests

The study tested several diagnostic tests. These tests were instrumental in assuring the quality of the data by validating assumptions about the data, checking for data anomalies

and outliers, and uncovering useful patterns that would help with the interpretation of the data.

Among the tests that were carried out include: The Shapiro-Wilk test, which was performed to discover if the data utilized for the investigation follows a normal distribution. The Variance Inflation Factor (VIF) test was utilized to check for multi-collinearity by measuring the degree of correlation between each predictor variable and all other predictor variables used by the study. VIF values of below 4 are an indication of moderate to zero correlation among the variables being investigated while VIF values of above 4 imply greater correlation among variables, which is problematic. The Breusch-Pagan Lagrange Multiplier (LM) test was used to evaluate the connection between the squared residuals and the predictor variables thus assessing the presence of heteroscedasticity.

The Ramsey RESET Test was used to test for model specification problems, explicitly whether any variables have been omitted or the functional form has been incorrectly specified. Lastly, the Durbin-Watson test tested for serial auto correlation.

The following tables show the study's findings:

Table 4.2: Shapiro-Wilk Test

	Kolmogorov-Smirnov ^a			Shapiro-Wilk		
	Statistic	df	Sig.	Statistic	df	Sig.
Capital Adequacy	.327	64	.000	.726	64	.000
Asset Quality	.316	64	.000	.394	64	.000
Management Efficiency	.146	64	.001	.894	64	.000
Liquidity	.160	64	.000	.723	64	.000
Firm size	.099	64	.182	.952	64	.012

a. Lilliefors Significance Correction

Source: (Secondary Data, 2023)

From Table 4.2, it was clear that asset quality, capital adequacy, management efficiency, liquidity, and firm size all had significance levels that were less than 0.05. Since each variable had a significance level of less than 0.05, the null hypothesis was rejected. At a 95% confidence level, the results of the normality test indicate that data collected for the variables had a significant departure from the normal distribution. However, such results are expected as capital adequacy, management efficiency, asset quality, liquidity, and firm size are affected by diverse market conditions such as the regulatory environment and economic performance as such it is difficult for the variables to follow a perfect normal distribution.

Table 4.3: VIF

	Collinearity Statistics	
	Tolerance	VIF
Capital Adequacy	.829	1.206
Asset Quality	.936	1.068
Management Efficiency	.788	1.269
Liquidity	.840	1.190
Firm size	.702	1.424

Source: (Secondary Data, 2023)

Results from the study revealed that the variance inflation factor for capital adequacy was 1.206, asset quality was 1.068, management efficiency was 1.269, liquidity was 1.190 and firm size was 1.424. These findings show that all variables had a VIF of above 1 and less than 1.5 thus it concluded that moderate or no correlation existed between the variables hence deemed acceptable.

Table 4.4: Breusch-Pagan Lagrange Multiplier

studentized Breusch-Pagan test

data: model

BP = 9.7308, df = 64, p-value = 0.0832

Source: (Secondary Data, 2023)

The Breusch-Pagan LM test's null hypothesis asserts that the regression model's residuals have constant variance, indicating that there isn't any heteroscedasticity. Similar to this, the alternative theory contends that the regression model's residuals show heteroscedasticity, or that the predictor variables impact the variance of the residuals. From the results, the p-value for the Breusch-Pagan test was found to be 0.0832. This p-value is above 0.05 thus the null hypothesis is accepted, inferring that the heteroscedasticity was not present in the data utilized for the study.

Table 4.5: Ramsey RESET

RESET test
data: model
RESET = 14.744, df1 = 1, df2 = 64, p-value = 0.0591

Source: (Secondary Data, 2023)

The null hypothesis in the Ramsey RESET test is grounded on the premise that the regression model is accurately specified and there is an absence of functional form misspecification. In other words, the selected predictor variables and any non-linear connections between them are sufficiently represented by the current model. The alternative hypothesis, on the other hand, contends that both the regression model and the functional form are incorrectly defined. Findings from the Ramsey RESET test show that the p-value is 0.0591, which is larger than a significance value of 0.05, thus we decline to reject the null hypothesis. Thus, this indicates that there was no specification problem with the model proposed for the data.

Table 4.6: Durbin-Watson Test

Autocorrelation	
Durbin-Watson	1.8525

Source: (Secondary Data, 2023)

The Durbin-Watson test's null hypothesis premises the residuals do not exhibit first-order autocorrelation, that is, there is no serial correlation and the residuals are independent. The alternative theory contends that the residuals exhibit first-order autocorrelation i.e. there is serial correlation between the residuals, proving that it exists. The Durbin-Watson statistic was found to be 1.8525. In general, Durbin-Watson statistics near 2 typically indicate non-

autocorrelation; a value close to 0 shows positive autocorrelation; and a value close to 4 points to negative autocorrelation. Thus, the study resolved that there was no serial autocorrelation in the data used for the study.

4.5 Regression Analysis

A statistical method for detecting if there is a linear relationship connecting one or more independent/predictor variables to a dependent variable is regression analysis. The method is also useful for evaluating how well the independent variables and the model as a whole fit the total variance explained. Ultimately, regression enables the modeling of data relationships, as well as the creation of predictions or inferences based on the statistics. To model the linear relationship between financial performance and factors such as liquidity, capital adequacy, firm size, asset quality, and management efficacy, a multiple linear regression approach was applied in this study.

ANOVA and coefficients tables, as well as the Model Summary, show the results of the regression study. The amount of variation in the dependent variable that the explanatory/independent variable can explain is shown in the model summary. The coefficients table illustrates how each independent variable affected the model's ability to predict the dependent variable, while the ANOVA table evaluates the model's statistical significance. The following tables display the outcomes of the regression analysis.

Table 4.7: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.782 ^a	.612	.580	.1009077

Source: (Secondary Data, 2023)

It was evident from the Model Summary table that the R square was 0.612. This shows that when company size, asset-quality, liquidity, capital sufficiency, and management efficiency were fitted as predictor variables, they explained variation in financial performance to a degree of 61.2%.

Table 4.8: ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	1.108	5	.222	21.514	.000 ^b
	Residual	.608	59	.010		
	Total	1.716	64			

a. Dependent Variable: Financial Performance

b. Predictors: (Constant), Firm size, Asset Quality, Liquidity, Capital Adequacy, Management Efficiency

The ANOVA table revealed the level of significance to be 0.00. The F-statistic measures the relationship between the within-group variance (error or residual) and the between-group variance (treatment effect). Greater F-values suggest greater variations in group means. When the null hypothesis (no significant differences between group means) is assumed to be true, the p-value shows the likelihood of getting the observed F-statistic or a more immoderate result. From the study's results, the significance level is less than the p-value of 0.05. Hence the model, fit with firm size, asset quality, management efficiency, capital-adequacy, and liquidity and as predictor variables, is statistically fit to predict financial performance.

Table 4.9: Coefficients

Model	Unstandardized Coefficients		Standard Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	-1.483	.191		-7.768	.000
Capital Adequacy	.390	.201	.169	1.945	.057
Asset Quality	.048	.065	.060	.738	.464
Management Efficiency	.059	.022	.234	2.622	.011
Liquidity	.041	.066	.054	.614	.542
Firm Size	.061	.008	.695	7.527	.000

a. Dependent Variable: Financial Performance

From the regression coefficients table, it was determined that the model fit for the data is:

$$Y = -1.483 + 0.059X_3 + 0.061X_5$$

Where:

Y = Financial Performance

X₁ = Management Efficiency

X₂ = Firm Size

4.5 Discussion of the Findings

From the coefficients table it is clear that the constant term is -1.483 this is an indication that when all the predictor variables have been held constant financial performance will have a value of -1.483.

Management efficiency had a beta value of 0.059. This means that for every unit increase in management efficiency, financial performance has a positive increase of 0.059 units.

Firm size had a beta value of 0.061. This means that for every unit increase of firm size,

financial performance has a positive increase of 0.61 units. The study also established that there is a positive and significant ($P < 0.05$) association linking internal factors and financial performance.

Capital adequacy had a beta value of 0.390. This implies that every unit increment in capital adequacy leads to a positive increase of 0.390 units in financial performance. Asset quality had a beta value of 0.048, alluding that every unit increase in asset-quality leads to a positive rise of 0.048 units in financial performance. Liquidity had a beta value of 0.041. This means that for every unit increase of liquidity, financial performance has a positive increase of 0.041 units.

The discoveries of this study are in alignment with those of Wijesiri, Viganò, and Meoli who in 2015 conducted research on the impact of internal factors such as social capital, structure, and customers on the performance of MFIs in Sri Lanka. From their study, it was concluded that capital adequacy and structure positively influenced the institutions' financial performance.

The results of this research paper also concur with those of Saad, Taib, and Bhuiyan who in 2017 undertook research in Pakistan to look into the factors that affected the outreach performance of microfinance institutions. The analytical results indicated that firm size, profitability, and return on asset positively and significantly affected the breadth and depth of the MFIs' outreach performance.

CHAPTER FIVE: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

The goal of the study was to assess how internal factors affected the financial outcomes of licensed deposit-taking micro-finance organizations in Kenya. This segment summarizes the findings, conclusions, and suggestions. The limitations of the study are also presented in this chapter, alongside recommendations for further research.

5.2 Summary of the Findings

From the Shapiro-Wilk test, it was laid out that the data used in the review didn't exhibit a normal distribution. This deviation from normal distribution was accounted for by the fact that firm size, asset quality, capital adequacy, management efficiency, and liquidity were affected by varying market conditions. Additionally, the existence of extreme values or outliers in the data might skew the distribution, causing the data to not follow a normal distribution. For instance, a non-normal distribution could result from some microfinance institutions having extraordinary financial performance that is notably different from the rest of the population. Further, the microfinance sector consists of a wide range of institutions, each with its own distinctive traits, modes of operation, and degrees of performance. A non-normal distribution may develop from this heterogeneity, particularly if the sample contains institutions with wildly divergent financial records. Owing to the presence of a limited number of huge institutions or outstanding efficiency outliers, some of the variables, such as firm size or management efficiency, may be naturally biased.

Findings from the variance inflation test showed that there was no multi-collinearity present between asset-quality, firm size, capital-adequacy, liquidity, and management efficiency. Results from the Breusch-Pagan test showed that heteroscedasticity was absent in the data that was used for the study. Further, the Ramsey Reset test indicated that there were no specifications issues in the model that was utilized for the study.

From the Durbin-Watson test, it was shown that there was non-autocorrelation in the data utilized for the research. From the regression model, it was noted that firm size, asset quality, liquidity, capital-adequacy, and management efficiency explained 61.2% of the disparity in profitability. In addition, firm size, asset quality, liquidity, capital adequacy, and management efficiency were all proven to be positive predictors of financial performance.

5.2 Conclusion

From the outcome, it was evidenced that the size of the firms had a progressive effect on the financial results of the MFIs. This implied that it was expected for larger MFIs to perform better compared to smaller MFIs. These findings also suggested that MFIs should pay attention to strategic factors that could influence their growth and thus financial performance.

Asset quality also proved to be a positive predictor of financial performance. It was thus noted that it was crucial for the MFIs to maintain a portfolio that had more performing loans as compared to the non-performing ones. Capital adequacy was established to be a positive predictor of financial performance. These results suggested the importance of the

MFIs to maintain substantial capital reserves to cushion them during times of economic instability.

Liquidity was also found to be a positive predictor of financial performance. Therefore, these results lay emphasis on the need for MFIs to maintain enough liquidity to enable them to meet their financial obligations promptly and sufficiently. Management efficacy also proved to be a positive predictor of financial performance. These findings highlighted the need for the MFIs to have a sound management team.

5.3 Recommendation

Given the study's conclusions, the research recommends that in order to maintain high asset quality it is imperative for the MFIs to diversify their loan portfolio to reduce the risks associated with them. It is also recommended that the MFIs put mitigation strategies in place that ensure that performing loans are always more than non-performing loans.

The study also recommends that the MFIs regularly check their capital adequacy. This is in a bid to ensure that the MFIs are always in a position to have enough capital reserves that could cushion them from financial strains that could be experienced in the economy.

The study also recommends that the MFIs develop rigorous liquidity policies that can test and identify vulnerabilities. In addition, it is recommended that they maintain adequate cash reserves to cover short-term obligations and potential cash flow changes.

Lastly, this study recommends that management teams of the MFIs embrace technological advancements to help them become more efficient. Further, it is recommended that the MFIs hold regular refresher training for their management to keep them up to date with new techniques and thus enable them to perform better. The study further recommends that

for the MFIs to achieve firm size growth they should put in place strategic practices that would foster sustainable expansion.

5.4 Limitations of the Study

The data source's original intent and purpose posed one limitation. The data that was used in this study was first gathered for non-academic purposes. However, it is noteworthy that the study was able to restore it in a way that can be utilized for the research. In addition, the data was retrieved from audited financial records, which typically adhere to rigorous quality and accuracy standards. Therefore, while the data may have been initially generated for non-academic reasons, its reliability can generally be relied upon for our research objectives.

The research was also restricted to a 5-year timeframe from 2017-2021 which may not capture long-term trends or the full impact of internal factors on financial performance. It is possible that financial performance can be influenced by factors that extend beyond this period. This implied that the findings of the study were limited to this period and hence cannot be inferred to any other period.

The study was limited to licensed deposit-taking MFIs in Kenya. While this might provide a comprehensive view of the microfinance sector, a larger sample size, that included more MFIs might have increased the statistical power of the analysis and allowed for more generalizable conclusions. It may therefore not be appropriate to generalize the findings of this study to other countries or types of financial institutions without further research.

5.5 Suggestions for Further Studies

From the conclusions of this research, it was determined that 61.2% of the disparity in earnings was elucidated by asset quality, liquidity, firm size, capital sufficiency, and management efficacy. Thus it is imperative for further scholars to inspect what additional aspects account for the remaining 38.8% variation in financial performance.

The research was restricted to a 5-year timeframe. It is important that other researchers look into other time frames other than the ones investigated. This is because economic and regulatory conditions can change over time, and a longer or more recent time frame might provide a different perspective on the relationship between internal factors and financial performance. This will aid in determining decisively how internal factors influence the financial performance of MFIs.

This study focused on a specific set of internal factors, namely asset quality, liquidity, firm size, capital sufficiency, and management efficiency, to explain the variation in financial performance. It is therefore vital for other researchers to explore external factors that may play a significant role in financial performance disparities among microfinance institutions. Thus a more comprehensive knowledge would exist on the range of factors that affect financial performance in MFIs.

MFIs fill a unique and dynamic niche in the financial industry. They frequently face particular challenges and opportunities that may not have been fully covered in this study. It is therefore highly advised that future research initiatives strive to delve further into industry-specific characteristics. Researchers will be able to learn how these particular

aspects affect financial success by grasping the complexities of microfinance, including its legal structure, customer base, and mission-driven nature.

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APPENDICES

Appendix I: List of Licensed Deposit Taking Microfinance Institutions in Kenya

1. Caritas Microfinance Bank Limited
2. Century/ Branch Microfinance Bank
3. Choice Microfinance Bank Limited
4. Daraja Microfinance Bank Limited
5. Faulu Microfinance Bank Limited
6. Kenya Women Microfinance Bank
7. Rafiki Microfinance Bank Limited
8. SMEP Microfinance Bank Limited
9. U & I Microfinance Bank Limited
10. Uwezo Microfinance Bank Limited
11. Maisha Microfinance Bank Ltd
12. Sumac Microfinance Bank Limited
13. Key/ LOLC Microfinance Bank Limited

Source: CBK Report (2020)

Appendix II: Research Data

Microfinance Bank	Year	Financial Performance	Capital Adequacy	Asset Quality	Management Efficiency	Liquidity	Firm size
Caritas Microfinance Bank Limited	2017	-0.0807	0.1880	0.6220	0.6295	0.7041	20.5939
	2018	-0.1888	0.1950	0.0388	0.6692	0.4055	20.9418
	2019	-0.0298	0.1880	0.0077	1.0337	0.5320	21.2611
	2020	0.0021	0.1900	0.0400	0.9699	0.0950	21.5747
	2021	0.0057	0.1630	0.2422	1.0083	0.0911	21.8218
Century/ Branch Microfinance Bank	2017	-0.2196	0.1880	0.0290	0.4828	0.4066	19.4791
	2018	-0.0577	0.1950	0.0275	0.6845	0.2820	19.8805
	2019	-0.1267	0.1880	0.0168	0.6871	0.2552	19.6318
	2020	-0.2038	0.1900	0.1933	0.4734	0.3448	19.5070
	2021	-0.0191	0.1630	0.4185	0.9183	0.4609	19.8109
Choice Microfinance Bank Limited	2017	-0.4516	0.1800	0.1222	0.1593	0.2860	18.5983
	2018	-0.6103	0.1950	0.7828	0.1914	0.5693	18.3971
	2019	-0.3581	0.1880	0.3560	0.3383	0.5693	18.2071
	2020	-0.4585	0.1900	0.5380	0.3739	0.3514	17.6549
	2021	-0.5237	0.1630	0.0385	0.0974	0.2974	17.6198
Daraja Microfinance Bank Limited	2017	-0.3562	0.1880	0.0102	0.1669	0.8181	18.9368
	2018	-0.2546	0.1950	0.0045	0.2073	0.6238	18.9651
	2019	-0.3434	0.1880	0.1411	0.0981	0.8124	18.7056
	2020	-0.3552	0.1900	0.1843	2.7119	0.6365	18.5305
	2021	-0.2508	0.1630	0.0154	0.0753	0.6670	18.6370
Faulu Microfinance Bank Limited	2017	0.0037	0.1990	0.0612	1.2831	0.2970	23.9551
	2018	0.0070	0.1700	0.1326	1.1937	0.2700	24.0272
	2019	0.0111	0.1500	0.1250	1.2288	0.2600	24.1138
	2020	-0.0127	0.1140	0.1982	0.0054	0.2860	24.1146
	2021	-0.0146	0.1620	0.2109	0.0408	0.3420	24.0476
Kenya Women Microfinance Bank	2017	-0.5000	0.2420	0.1687	1.1531	0.2850	17.1804
	2018	-0.0280	0.1830	0.1887	0.9600	0.2050	24.1104
	2019	0.0171	0.2130	0.1836	1.0681	0.2400	24.1447
	2020	0.0530	0.1620	0.2459	0.8615	0.2040	24.0568
	2021	0.0072	0.1610	0.2813	1.1932	0.2560	24.0176
Rafiki Microfinance Bank Limited	2017	-0.1232	0.2700	0.2699	0.4354	0.1800	22.5979
	2018	-0.0259	0.2000	0.4303	0.7471	0.2100	22.5017
	2019	-0.0451	0.1200	0.6636	0.8016	0.3900	22.4207
	2020	-0.0265	0.0700	0.6412	0.8933	0.3100	22.4694
	2021	-0.0251	0.1750	0.6048	0.9074	0.3960	22.5023
	2017	-0.0440	0.1800	0.0008	1.0690	0.2300	21.7289

SMEP Microfinance Bank Limited	2018	-0.0054	0.1700	0.1904	0.9784	0.2200	21.8022
	2019	0.0059	0.1500	0.1561	1.1283	0.2700	21.9214
	2020	-0.0200	0.0600	0.1721	0.9401	0.2300	21.9604
	2021	-0.0137	0.0562	0.2463	1.0044	0.2396	21.9417
U & I Microfinance Bank Limited	2017	0.0346	0.5030	0.0781	1.2121	0.2020	19.5978
	2018	0.0170	0.4730	0.1035	1.2511	0.2060	20.0971
	2019	0.0061	0.3560	0.0396	1.2849	0.1670	20.3470
	2020	0.0146	0.3450	0.0437	1.4475	0.2190	20.5066
	2021	0.0240	0.3110	0.0772	1.7258	0.2660	20.7290
Uwezo Microfinance Bank Limited	2017	-0.0567	0.1880	0.5752	0.8013	0.4178	19.1698
	2018	-0.1386	0.1950	0.0454	0.5849	0.2079	19.2303
	2019	-0.4221	0.1880	0.0244	0.3795	0.2772	18.9392
	2020	-0.1719	0.1900	0.4109	0.5152	0.3669	18.7147
	2021	-0.0914	0.1630	0.4110	0.1569	0.6191	19.8867
Maisha Microfinance Bank Ltd	2017	-0.1294	0.1880	0.0554	0.4364	0.1011	19.5276
	2018	-0.4139	0.1950	0.1023	0.3104	0.8816	19.4803
	2019	-0.0302	0.1880	0.0406	0.9763	0.8086	20.9578
	2020	-0.0764	0.1900	0.3522	0.7236	0.7057	21.3314
	2021	-0.1204	0.1950	0.6825	0.6824	0.6141	21.1155
Sumac Microfinance Bank Limited	2017	0.0089	0.1880	0.0014	2.2768	0.8089	20.8520
	2018	0.0103	0.1950	0.0065	2.3534	0.8627	21.1889
	2019	0.0090	0.1880	0.0062	2.7132	0.7883	21.4230
	2020	0.0049	0.1900	0.0123	2.4772	0.7132	21.5604
	2021	0.0057	0.1950	0.0104	2.5922	0.5903	21.8341
Key/ LOLC Microfinance Bank Limited	2017	-0.0701	0.1880	0.0221	0.7356	0.4793	19.6864
	2018	-0.0979	0.1950	0.0982	0.6318	0.4590	19.8873
	2019	-0.0845	0.1880	0.0217	0.5411	0.4711	19.8210
	2020	-0.1107	0.1900	0.0068	0.5257	0.4447	19.5419
	2021	-0.1750	0.1950	0.0992	0.2971	0.4852	19.4827