

**NEXUS BETWEEN FINANCIAL MANAGEMENT PRACTICES AND  
FINANCIALSTABILITY OF DEPOSIT TAKING MICROFINANCE  
INSTITUTIONS IN KENYA**

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## DECLARATION

This research project is my original work and it has not been presented and submitted to any in university or college for examination.

Signed .....  .....

Date ..... 21/11/2022 .....

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This research project has been presented for examination with the authority and approval as the university supervisor.

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## **DEDICATION**

This project is devoted to my family for being patient with me while undertaking this study

## ACKNOWLEDGEMENT

I would like to give special thanks to the following people and organizations for their invaluable assistance during the process of writing this project. I would like to begin by expressing my sincere appreciation to the University of Nairobi for providing me with a rigorous academic environment in which I was able to acquire the necessary knowledge, directions, and instructions to lay the groundwork for this study. Second, I value the feedback and suggestions from my professors that helped me shape my study idea. I'd like to thank the department's instructors in the appropriate academic areas for their assistance as well. We learned a lot from it, and it enriched our lives. Thirdly, I'd want to express my gratitude to all of my fellow college students. Lastly, I'd want to express my gratitude to my loved ones who have been so supportive of me while I've pursued my education. Thanks to everyone who has supported me and given me ideas while I worked on my project report.



## ABSTRACT

Businesses in the current world have to contend with a fierce level of competition, which makes it imperative for each company to have a rock-solid foundation in terms of its financial situation in order to be able to thrive in the ever-changing market environment. The objective of this study was to establish the nexus between financial management practices and financial stability of deposit taking MFIs in Kenya. This study was guided by pecking order theory, contingency theory and trade off theory and cash conversion cycle. The research design used in this study was a descriptive survey. A survey of all 9 deposit-taking MFIs with appropriate licenses were conducted for this research. Secondary information was gleaned from financial statements, and each aspect of financial management was examined for the years 2017-2021. This study used the social science statistical tool SPSS version 24 to examine the acquired data. The study utilized the regression model to estimate the correlation between deposit-accepting MFIs' financial stability and their usage of sound financial management techniques in Kenya. Results depicts that there is a significant positive relationship between financial stability of MFIs in Kenya and working capital. Secondly, the findings showed that there is a weak positive significant relationship between financial stability of MFIs in Kenya and financial structure. Also, there was a significant positive relationship between capital adequacy and financial stability of MFIs in Kenya. Further, there was a significant positive relationship between asset quality and financial stability of MFIs in Kenya. Finally, the findings showed that there is a positive significant relationship between management quality and financial stability of MFIs in Kenya. According to the findings of the research, managers working for microfinance institutions (MFIs) should provide a high level of priority to financial management practices while developing organization strategies. This will improve the company's financial operations by increasing their openness, accountability, and consistency. Nevertheless, the research suggests that management should give great consideration to the architecture of their own organizations before implementing financial management strategies. Because businesses have varying financial structures, this will help guarantee that the procedures that are implemented are appropriate for that specific company

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## ABBREVIATIONS AND ACRONYMS

**AIS:** Accounting information systems

**AMFI:** Association of Microfinance institutions

**CBK:** Central Bank of Kenya

**CSM:** Capital structure management

**FAM:** Fixed Assets Managing

**FRA:** Financial reporting and analysis

**MEs:** Small and medium-sized enterprises

**MFI:** Microfinance institutions

**NSE:** Nairobi Securities Exchange

**US:** United States

**WCM:** Working Capital Management

## CHAPTER ONE: INTRODUCTION

### 1.1 Background of the Study

Pandey (2017) 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 financés 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.

This study was guided by pecking order theory, contingency theory and trade off theory and cash conversion cycle. The pecking order hypothesis sheds light on how the most effective corporate capital structures might be designed (Myers & Majluf 1985). According to the theory of contingencies, the only way to make sure that operations are running smoothly is to make sure that corporate settings and financial systems work together smoothly. The "trade-off theory" by Black and Sholes (1974) shows how the cost of money in times of trouble is different from the tax advantage of businesses. The cash conversion cycle shows how well a company turns its income into cash that can be used (Gitman, 1974).

The methods of financial management that institutions in Kenya use, such as financial analysis and forecasting, budgetary controls, cash management techniques, and financing choices, all have a direct bearing on the degree to which deposit-taking MFIs in Kenya are able to maintain their financial stability. Some microfinance institutions (MFIs) still don't appear to have figured out how to handle their money optimally, leaving them open to financial risk, competition, and mismanagement. Companies with sound financial management techniques have seen their financial positions strengthen (MFI, 2020).

### **1.1.1 Financial Management Practices**

Moore and Reichert (2017) define financial management practices as the activities or competencies that are carried out by an accountant, chief financial officer, and board of management in the areas of budgeting, procurement and supply, asset management, and financial control. These practices are also referred to as "best practices" in the field of

financial management. The following techniques of financial management are often used by businesses: financial reporting and analysis (FRA), management of fixed assets (FAM), management of accounting information systems (AIS), management of working capital (WCM), and management of capital structure (CMS) (CSM). The successful implementation of these processes is essential to effective financial management in any organization.

The term "accounting information system" (AIS) is used to describe a comprehensive framework used by businesses to convert economic data into financial information using a variety of financial and physical resources (Bhat 2019). This view is shared by that of Thomas and Kleiner 1998) who noted 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 (2018) 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.

According to Boateng (2020), a company's capital structure is the mix of debt and equity financing it employs. Capital structure is a subset of financial structure that depicts the long-term sources of an organization's resources, including both short-term debt and long-term debt as well as preferred stock and common equity.

Adequate capital, quality of assets, soundness of top management, earnings quality, and liquidity (abbreviated CAMELS) are some of the most widely used metrics of MFI soundness, as accepted in Basels Acord (Beck et al., 2009). Ghosh has proposed the banking stability index as a universal assessment of MFI stability (2010). The metric is derived from a collection of necessary and sufficient factors related to banking operations, with consideration given to which groups of components have the most influence on the indices. Z-score and the percentage of nonperforming loans are two common accounting-based measures of both individual and combined bank soundness (Beck et. al., 2009; Ongore & Kusa, 2013; Ghosh, 2008).

Inadvertently beginning in 2007, Kenya has achieved great achievements in expanding financial inclusion, which has improved the financial soundness of banks and boosted economic development. There are a lot of factors that have led to the increased participation. Getting people like commercial banks and other financial institutions to work with you is step one (CBK, 2012). Second, it is highlighting financial inclusion as a national objective in the Vision 2030 document. Last but not least, it is becoming more accessible thanks to the forward-thinking practices of the financial industry, most notably those of commercial banking institutions.

### **1.1.3 Financial Management Practices and Financial Stability**

According to Moore and Reichert (2017), while considering the relationship between financial management practices and the performance of businesses, it is important to account for the fact that other factors may either boost or hinder performance. The aforementioned elements do not have a direct bearing on the connection between financial management and



organizational effectiveness. The writers are adamant that their work be taken into account. To get rid of the negative effect they have on productivity inside a company. In Padachi's (2017) view, a company's fortunes may be affected by both internal and external factors. External impacts include things like money (particularly the availability of attractive financing), economic conditions, competition, government regulations, technological advancements, and environmental factors. Management quality, staffing levels, and documentation practices are all examples of internal factors.

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 raising 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 Deposit taking MFIs in Kenya**

The government of Kenya enacted the Microfinance Act in 2006 to aid with the regulation of all MFIs in Kenya the nation. Businesses that "take money from members of the public on current account and payment on and acceptance of checks and on deposit repayable on demand or at the expiration of a predetermined time or after notice" are considered deposit-taking microfinance institutions under the Microfinance Act (2006). Deposit-taking MFIs, according to the Central Bank of Kenya (2019b), "employ the money held on deposit or on current account, or any part of the money, by lending, investing for the account and at the risk of the institution," typical examples include the use of collateral replacements in the granting of short-term loans to small and medium-sized enterprises (SMEs) or low-income families.

The Central Bank of Kenya is responsible for registering and licensing deposit-taking microfinance institutions (MFIs) under Section 5 of the Microfinance Act (2006). There are two main types of microfinance institutions recognized under the Microfinance Institutions Regulations (2008): those serving a local community and those serving a wider geographic area. According to Section 13 of the Microfinance Act (2006), a deposit-taking MFI may not do business outside of Kenya. For a deposit-taking MFI to be licensed, the Central Bank of Kenya (2019b) states that it must "place a notice in the Kenya Gazette, therefore legally permitting the applicants to launch the deposit-taking microfinance business."

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Appendix I provides a list of the 13 Kenyan MFIs that were authorized to accept deposits during 2018–2019. (Central Bank of Kenya, 2019b). Kenya's strict regulations on deposit-taking MFIs guarantee the institutions' solvency and the security of their customers' money. In contrast to MFIs that don't accept deposits, those that do must have a larger amount of capital on hand at all times. This aids in ensuring that all deposit-accepting MFIs have enough resources, which may assist them avoid the risk of using customers' deposits for capital expenditures (Tettey, 2017). As of 2017 (Tettey). Microfinance institutions (MFIs) can only be financially stable if they take reasonable precautions to ensure that their borrowers can afford to repay their loans (low default of loan) and that appropriate background checks are performed before loans are disbursed (Aidoo & Mensah, 2018).

## **1.2 Research problem**

Businesses in the current world have to contend with a fierce level of competition, which makes it imperative for each company to have a rock-solid foundation in terms of its financial situation in order to be able to thrive in the ever-changing market environment. Because of the aforementioned circumstances, corporations are toiling away around the clock in order to achieve a more intimate and amicable relationship with their various stakeholders. This indicates that having a method of decision making that is sage, appropriate, and open to various perspectives is highly crucial.

It has been stated by a number of academics that in order for managers to be able to properly cope with the difficult market climate, they need to have a high degree of effective financial management as well as abilities in information technology. For example, if a company is

going through a period of economic difficulty, the managers of that organization need to be able to adapt extremely fluidly to the new circumstances in order to ensure the survival of their respective enterprises. Because these businesses are obligated to fulfill all of the demands and expectations of their customers, effective financial management of the firm is very necessary for achieving greater levels of productivity.

Mitchell (2016) found that accounting information systems are crucial because they help businesses to solve their short-term problems and provide managers the ability to make informed choices. In the most recent article, the results of many research conducted by a variety of academics have been compiled, and they have come to the conclusion that efficient and effective administration of an organization's finances may help to the success of such companies in today's time (Baker 2003). The findings of other research on the relationship between effective financial management and company success have been contradictory. Moore and Reichert (2017), for instance, looked at 500 US-based businesses to see whether there was a correlation between the usage of advanced analytical techniques and financial success. Evidence suggests a beneficial relationship between these two factors, as they discovered. They came to the conclusion that businesses that invested in technologically advanced machinery had a greater likelihood of achieving superior results than those that did not make such investments.

At the local level, Kamande Kelvin Macharia conducted research on "The relationship between financial management practices and financial performance in the dairy industry in Kenya," and he came to the conclusion that "without the fair financial management practices,



the financial performance of the dairy processors will be four." Beyond this, he found that the management of a company's non-current assets, capital structure, and working capital had little effect on the company's success. Geoffrey Kiita Kitonga conducted a study on the correlation between financial management practices and business success in Kenya's shipping industry (2013). Originally released in 2013, the study has since been updated. He observed that the financial management practices had a favorable influence on the performance of the shipping firms and that the majority of the shipping companies had adopted financial management practices. Financial management procedures were shown to have a favorable effect on the efficiency of shipping enterprises, another finding of his.

Berryman and Peacock's (2019) investigation into the causes of business failure found that poor financial management is one of several variables that might lead to a company's demise. However, Wammer (1973) studied the correlation between advanced capital budgeting techniques and financial success in the United States. Despite the widespread use of advanced capital budgeting procedures, he discovered no reliable correlation between such approaches and financial success. After looking into it, he arrived to this conclusion.

The above explanation demonstrates very clearly that academics have a variety of responses to the above link between financial management techniques and the success of commercial organizations. This can be seen clearly from the explanation. This research is not intended to refute the conclusions of the studies that came before it; rather, it is aimed to add to those findings by examining them from the point of view of microfinance organizations. This study will therefore shade more light on the financial management practices adopted by various

deposit taking micro finance organizations by asking the question: what is the nexus between financial management practices and financial stability of deposit taking MFIs in Kenya?

### **1.3 Objectives of the Study**

The objective of this study was to establish the nexus between financial management practices and financial stability of deposit taking MFIs in Kenya.

### **1.4 Value of the Study**

Both academic and policy audiences will be able to see how this research benefits their work. At the academic level, A number of studies have been on this subject of financial management practices in relationship to financial stability, 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. Since there has been no comprehensive study of micro-finance institutions, the results and suggestions of this study will help fill this knowledge gap and provide a forum for debate and discussion among finance students and scholars. This research will provide the groundwork for future studies.

Policymakers may get valuable insight into best practices for financial management from this study's results and suggestions. Our analysis will focus on the effects of current methods of financial management on the long-term viability of these businesses. Second, the research will provide vital insight for businesses and, in particular, microfinance institutions, into the tactics they should use to formulate policies that include financial management best practices, therefore strengthening their own financial security.

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. The research next addressed the topic of the factors that influence financial management practices, followed by an explanation of the empirical literature review and, finally, the conceptual framework of the study. A conclusion will be given at the end of it all.

### **2.2 Theoretical Framework**

The pecking order theory, which was developed by Myers and Majluf (1985), the contingency theory, which was developed by Pike (2014), the trade-off theory, which was developed by Black and Sholes (1974), and the cash conversion cycle theory are all connected to the practices of financial management (Gitman, 1974).

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

Myers and Majluf are the originators of this hypothesis (1985). Firm finance choices provide the theoretical foundation of the model. According to this hypothesis, companies will always look inside their own ranks for funding. When it comes to money, most businesses stick to a tried-and-true method that prioritizes internal resources before looking outside for funding. When given the choice between using debt and keeping revenues in-house, most businesses will choose to keep the money. Short-term debt has a shorter payback period, which is appealing to certain companies, whereas long-term debt requires repayment over a longer period of time and often incurs higher financial expenses in the form of interest payments. To combat information asymmetry, non-issuance entities are useful.



With the growing gap in knowledge between insiders and outsiders, the cost of issuing new shares of stock might increase (Pandey, 2005). Issues of stock are often reserved for really dire situations when all other options have been exhausted and a company is desperately in need of external capital. An organization will prioritize its own resources above those of outsiders whenever possible, as supported by the pecking order hypothesis of funding.

The pecking order theory, according to Desai (2015), is incorrect because it places too much emphasis on the costs of securing finance and too little on the other factors that are likely to affect the choice of financing by different firms. Elements like as governmental laws, interest rates, and the nature of the borrowers' and lenders' connections are all important factors to consider. According to this notion, sound financial management techniques are necessary for organizations to make informed judgments. Companies may better manage their money as a result of these methods. The hypothesis suggests that if one is well-versed in the methods of financial management, one may reduce potential threats to the financial system and so increase its stability.

### **2.2.2 The Contingency Theory**

According to Pike's (2014) theory, improving the effectiveness of resource allocation requires thinking about more than simply the use of effective tools and methods; it also requires thinking about the capital budgeting system's larger context, design, and implementation. The fields of management and organizational science find this idea to be very applicable. In the field of accounting, its importance cannot be overstated. According to this idea, there are four broad categories of influencing factors: environmental, user,

organizational, and social. These four factors are crucial to every company's reporting system.

The theory's central claim is that certain methods of corporate finance management are more appropriate for some businesses than for others. This is because of internal and external variables unique to each corporation. That means businesses aren't required to follow any certain set of procedures when it comes to managing their finances. Therefore, it is important to assess the specific company environment to determine which financial management strategies would be most effective in attaining the goals of the organization. Only when there is harmony between the corporate environment and the workings of the financial system can we expect to see a favorable impact on the firms' financial performance (Pike, 2014).

Schweikart's (1985) observations that the development of national accounting systems varies from one state to the next due to the unique characteristics of each nation's environment lend credence to the hypothesis. Thus, MFIs will be aided by this theory in their allocation of resources by taking into account external and internal elements, such as environmental and societal conditions, user traits, and the organization's own strengths and weaknesses. This theory is also relevant to the research since it provides guidance to MFIs as they develop ways to succeed in a challenging economic climate.

### **2.2.3 Trade off Theory**

The authors of this hypothesis are Black and Sholes (1974). This hypothesis helps to explain the nuances between the interest rate on loans taken out during times of financial hardship and the tax savings realized from the advantageous position of debt within the capital

structure. Thus, the final capital structure selected by the company represents a compromise between potential benefits and associated costs. This implies a goal of debt-to-equity ratio.

Consequently, the best capital structure is the one that maximizes benefits while minimizing costs. This theory presupposes that there are advantages to using leverage in the capital mix until an optimum capital structure is reached. Investors will not be interested in a firm with a high amount of debt because of the high degree of risk involved. Despite this, academics examining the trade-off idea have reached contradictory conclusions. Contrary to the actual trade off forecast that the most successful organizations should seek for higher debt in order to decrease tax obligations, research by Titman (2015) confirms that the most profitable enterprises are likely to borrow less.

#### **2.2.4 Cash Conversion Cycle Theory**

If you have a longer cash conversion period, you'll have greater financial results, says Gitman (1974). Any company should have a cash conversion cycle in place so that it can gauge its cash needs. The time it takes to bring in enough money and stock up on supplies is a major focus of the idea known as the "cash conversion cycle." Each part of a business that has an effect on the company's cash flow should evaluate its own cash conversion cycle and make any necessary adjustments.

A shorter cycle indicates that less resources are needed to run a firm. When the cash conversion cycle is quick, it means that the organization can get by with less resources. When the time it takes for money to change hands is lengthy, it's a sign that the firm is flourishing, which in turn indicates more profits and better financial results (Gitman, 1974).



## **2.3 Determinants of Financial Stability**

Many businesses have found that maintaining their financial stability is a fine line. This is because most businesses continue to fall short even if they have developed several tactics to improve their performance. In this way, we can see that working capital management, financial structure, capital sufficiency, asset quality, and management quality are only few of the many elements that affect financial success.

### **2.3.1 Working Capital Management (WCM)**

Garrison (2017) noted 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 be performed using quick ratios such as working capital/total asset and current assets/total asset.

### **2.3.2 Financial structure**

While the notion of a company's financial structure is crucial, many laypeople may not understand what this phrase means or why they should care about it, despite its frequent use by corporate leaders, professional investors, and analysts. Firm financial structure study has become more popular as a result of the growing body of academic work in the field of finance. It has been the subject of several research to determine the impact of capital structure choice on company success (Khan, 2011). Owolabi and Inyang (2013) explain that



some types of funds, like share capital and reserves owned fund, are held indefinitely by the business, while other types of funds, like long-term borrowings or debentures, are held for a longer period of time and still others are in the nature of short-term borrowings. A company's financial structure, which includes the sum of all these parts, is what really finances the business.

### **2.3.3 Capital Adequacy**

There is strong evidence from cross-sectional research that capital sufficiency improves commercial = financial performance. Capital adequacy was analyzed in relation to financial performance for a sample of publicly traded Nigerian deposit money banks between 2010 and 2015. Nestor, Leonard, and Okoye (2017). Financial results were shown to be positively correlated with capital adequacy levels. Finally, the study showed empirical support for the hypothesis that capital sufficiency affects the financial performance of deposit money banks at the (5%) level of significance. Some studies have demonstrated that commercial banks' financial results suffer when capital adequacy requirements are met (Musyoka, 2017). Capital adequacy has been shown to have little impact on economic performance in other research (Mugwang'a, 2014).

### **2.3.4 Assets Quality**

The quality of an institution's assets has a significant impact on its performance since it affects interest earnings and, at the same time, lessens the weight of bad debts management costs required by regulation. To cover potential losses from loan defaults, banks must maintain cash reserves, the cost of which may be deducted from their profits. It is envisaged

that the trade-off between asset quality and financial performance would be unfavorable if the NPA ratio to gross/net assets book is high (Ombaba, 2013).

### **2.3.5 Management Quality**

Poor profitability is mostly caused by careless handling of costs (Sufian and Chong 2009). The literature on bank performance indicates that the efficiency of management may be gauged in part by how effectively it keeps operational costs in check. According to Mathuva (2009), local banks' Cost Income Ratio (CIR) is high in comparison to banks in other countries, hence they need to cut expenses in order to compete internationally. High interest rates in Kenyan banks are investigated by Beck and Fuchs (2004). One of the key factors in the large interest rate spreads was shown to be overhead costs. Overhead expenses were determined to be driven by employee salary expenditures, which were found to be higher than average when compared to comparable banks operating in SSA nations.

## **2.4 Empirical Literature Review**

The relationship between effective financial management and company success has been the topic of several studies. These are some of the studies that have been conducted on a global scale:

### **2.4.1 International evidence**

Using financial statement analysis, D'Amboise and Gase (2016) investigated the practices of small manufacturers in Quebec, Canada. They found that small businesses in the plastics and footwear industries routinely conducted financial reporting, which aided in the formation of most of their strategic choices. This study was reinforced by that of De Thomas and Fredenberger (2017) 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. Some people relied on summaries of activities and financial reconciliations. A further 61% of those surveyed said financial statements were very helpful in providing them with crucial information that affected their plans and actions. However 11% of the respondents thought that they used financial statements as part of evaluating, making plans and decisions.

According to research conducted by Nguyen (2019) on the correlation between SME financial management practices and profitability in Australia, it was found that 88 percent of SMEs routinely assess the viability of potential capital projects before making investment decisions, and that these same 88 percent also placed a high priority on fixed asset management with the help of knowledge management techniques.

The Ugandan court Kijjambi (2014) created accountability for the local banking sector's financial results. Licensed local and international commercial banks were both averaged into the analysis. Data was collected from secondary source such as published financial statement for both independent and dependent variables of the study. Multiple linear regressions used across a 10-year time frame revealed that managerial effectiveness, asset quality, interest income, capital sufficiency, and inflation all play a role in the success of Uganda's domestic banks over the study's time frame.

From 2019 to 2011, Oni et al. (2012) analyzed how different financial performance methods impacted businesses in Nigeria. The study relied on survey data for its findings. Researchers



looked at data from 72 different businesses. Both primary and secondary sources were used in this investigation. Additionally, regression analysis was used. The results of the research showed that financial performance techniques did not have a substantial impact on financial performance.

#### **2.4.1 Local Evidence**

Domestically, Mundu (2017) investigates how small and medium-sized enterprises (SMEs) do when it comes to implementing best practices in financial management and maximizing profits. 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.

Ouma (2015) conducted research to ascertain whether or whether non-listed firms on the NSE make use of financial management principles, and if so, to what degree this aids Kenya's economic development. Primary data from 41 firms not listed on the NSE were gathered via questionnaires given to randomly selected company managers. The research showed that 75% of businesses accepted cash payments for product sales and 92% utilized a manual inventory record. Of the 45% that used internal money for financing, 35% invested in long-term assets. The research also found that 55% of the companies surveyed do not utilize a formal accounting system and that 74% of the companies surveyed created their financial

statements without the help of a certified accountant. It follows that firms need training and education on better financial management techniques.

Financial accounting standards adoption and their impact on the financial performance of public companies in Kenya were the subject of a study by Bare (2016). Eight public companies were selected at random via two selection methods: stratified and simple. The information was gathered with the use of questionnaires, and the reliability was checked using the Cronbach alpha coefficient. Using SPSS 21 and inferential and descriptive statistics, we evaluated the gathered data. Using a multivariate regression model, we found that manufacturing companies' financial performance improved when they started using the generally accepted accounting principles. Based on these findings, it seems that the implementation of financial accounting standards has no substantial impact on the financial performance of public enterprises in Kenya. However, the research was unable to find evidence of any alternative forms of financial management outside of state-owned firms.

A research by Farhatali (2017) examined how effective strategic finance management benefits Nairobi-based businesses. Company executives were found to feel that WC, which included inventory and cash management, had an impact on the success and security of their organization. Most Nairobi business owners lacked the funds necessary to develop their operations, so they relied on educated intuition when determining the viability of potential investments. However, Nairobi business owners had not put money into long-term projects or opportunities because they lacked the resources (access to capital) to implement technological solutions, and they had also avoided taking risks because their businesses

lacked the resources to sustain themselves in the event of failure. It was not possible to draw any firm conclusions on the nature of the link between the studied variables.

Financial management strategies and financial performance in Kenya's dairy business were examined by Kamande Kelvin Macharia (2015). His research led him to conclude that the success of the dairy industry depends on the implementation of the four tenets of sound financial management. Working capital management is also important for the effective running of dairy businesses. Financially, this will benefit the company in a wide range of ways over time.

Financial management strategies and financial performance in Kenya's shipping sector were examined by Kiita Geoffrey Kitonga (2013). 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 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 stability.

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 stability of deposit taking MFIs in Kenya.

## 2.6. Conceptual Framework

### Independent Variables

### Dependent Variable

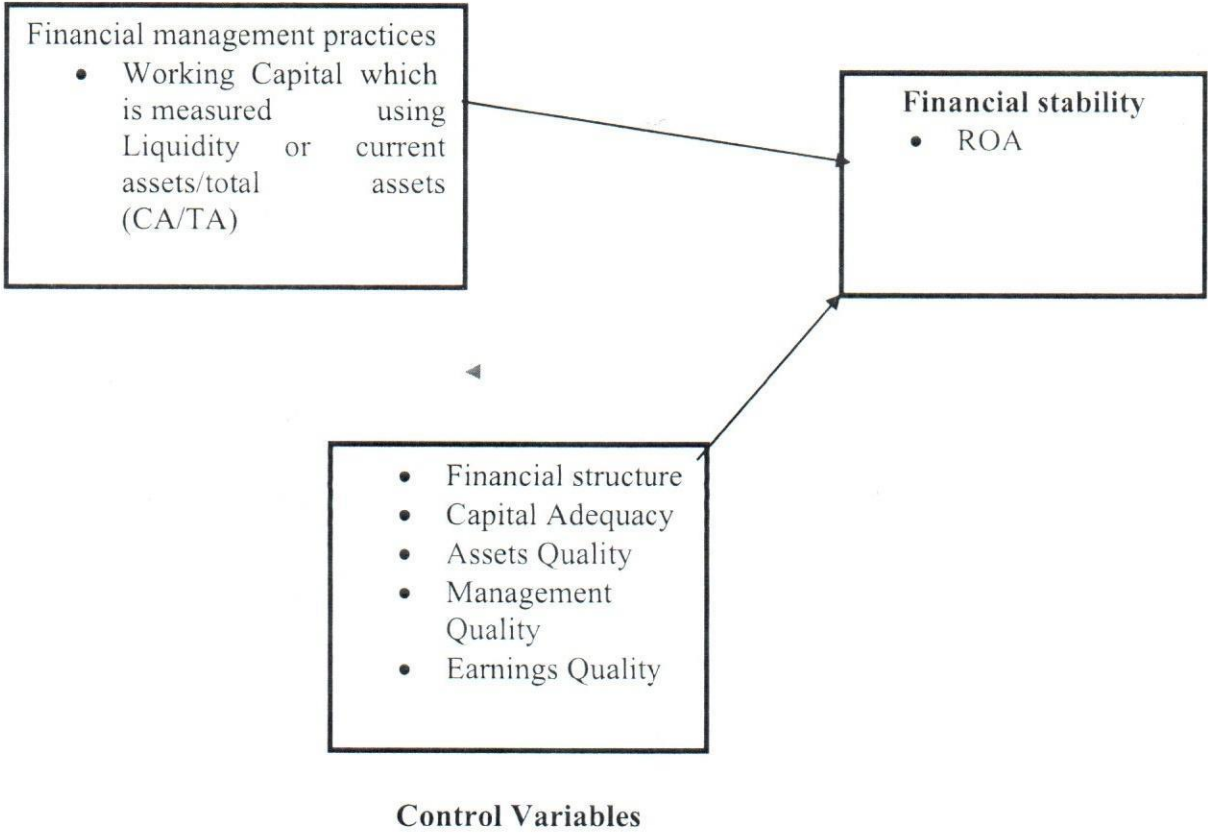


Figure 2.1: Conceptual Framework



## **CHAPTER THREE: RESEARCH METHODOLOGY**

### **3.1 The Introduction**

In this section, the study discussed the study's research methodology, including its selection of participants, methods of data collecting, formats for presenting and analyzing results, and so on.

### **3.2 The Research Design**

The research design used in this study was a descriptive survey. The ability to analyze a large number of Deposit-taking MFIs in Kenya with just a modest sample size was made possible by this strategy (Glass & Hopkins 2014). The deposit-accepting MFIs in Kenya were surveyed in a cross-sectional study, and a representative sample was selected using the purposive sampling technique. The reader was able to grasp the distribution of data once it had been collected and tabulated on graphs, pie charts, and tables. The purpose of this research was to determine whether or not there is a correlation between the ways in which microfinance institutions in Kenya handle their finances and their capacity to remain solvent.

### **3.3 Target Population**

In this case, the MFIs doing business in Kenya made up the research population and their activities served as the study's foundation for observations. Microfinance institutions in Kenya were the focus of this research. As of the end of 2019, nine Microfinance Institutions in Kenya have been granted licenses by the Central Bank to accept deposits (for a full list, see Appendix I) (attached). A survey of all 9 deposit-taking MFIs with appropriate licenses were conducted for this research.

### **3.4 Data Collection**

Secondary information was gleaned from financial statements, and each aspect of financial management was examined for the years 2017-2021. This research relied on publicly available financial statements from a range of microfinance firms as its secondary data source.

### **3.5 Data Presentation and Analysis**

This study used the social science statistical tool SPSS version 24 to examine the acquired data. The relevance of the regression model that describes the relationship between financial management practices and the financial stability of micro-finance organizations was tested using the coefficient of determination. Data was arranged in such a way that it was coded, and tabulated before it will be analyzed. These data that was presented was analyzed using descriptive statistics such as the use of tables, pie charts as well as cross tabulations.

#### **3.5.1 Diagnostic Tests**

The research used diagnostic procedures to ensure the accuracy of the results. Diagnostics focused mostly on normality, autocorrelation, and multicollinearity. The assumption of normality was tested by determining whether or not the residuals of the response variable are skewed significantly from the mean. The Kolmogorov-Smirnov Test and the Shapiro-Wilk Test was used to determine the distribution of the data. For the purpose of testing autocorrelation, the study used the Durbin-Watson method. Negative autocorrelation occurs when the statistic is more than two, whereas positive autocorrelation occurs when it is less than two. The research performed a multicollinearity test to check for any potential biases in the data and to make sure the independent variables are not interconnected. Multicollinearity

was tested by looking at the variation in asset quality. No multicollinearity existed if the VIF is between 1 and 10, but it was present if the VIF is less than 1 or larger than 10.

### 3.5.2 Analytical Model

The study utilized the regression model to estimate the correlation between deposit-accepting MFIs' financial stability and their usage of sound financial management techniques in Kenya.

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

Where:

$\alpha$  is model intercept

$\beta_1, \beta_2, \beta_3, \beta_4$  and  $\beta_5$  are the various intercepts

Y=financial stability measured by Return on Assets (ROT)

$X_1$ =working capital as measured using Liquidity or current assets/total assets (CA/TA)

$X_2$ = The Control Variables are financial structure, Measured as Total Liabilities/Total Assets

$X_3$ = Capital Adequacy Measured using Capital to Total Assets

$X_4$ =Assets Quality Measured as Non-Performing Loans to Total Loans

$X_5$ = Management Quality Measured as Cost to Income Ratio

$\varepsilon$  =the error in the model

### 3.6.3 Test of Significance

R<sup>2</sup> was used to see how well the potential explanations for the market value shift in the research hold up. Comparison of the computed value of F in the ANOVA Table with that F crucial from the F Table constitutes Analysis of Variance (ANOVA). The 5% significance threshold was used to evaluate the P values. T-tests also was used to evaluate the statistical

significance of the coefficients in the regression model. If the t value of a coefficient was more than two, then it was regarded to be statistically significant.



## CHAPTER FOUR: DATA ANALYSIS AND INTERPRETATION

### 4.1 Introduction

The results of the research on the influence of financial management practices on the financial stability of MFIs in Kenya are presented in this part. The study was carried out in Kenya. The first step in the analysis of secondary data was to do a descriptive analysis of the research variables. This analysis was done with the intention of getting a broad profile of the data. In addition, suitable regression diagnostic tests were carried out on the data in order to establish whether or not it was suitable for further statistical analysis. In addition to that, an estimate of the regression models was carried out, and an interpretation of the findings was carried out with the assistance of inferential statistics. The study made use of secondary data collected annually, and the time period it examined ranged from 2017 all the way up to 2021. The research collected comprehensive data for the time period under consideration. Utilizing secondary sources, the researcher was able to acquire information on MFI's working capital, financial structure, capital adequacy, asset quality, and management quality from their annual reports for the years 2017 to 2021.

### 4.2 Descriptive Statistics

Descriptive statistics comprises of the mean, standard deviation, maximum, minimum values, number of observations, skewness and kurtosis. Table 4.2 shows the descriptive results.

**Table 4.1: Descriptive Statistics**

		Minimu	Maximu		Std.		
	N	m	m	Mean	n	s	Kurtosis
ROA	45	0.01	0.38	0.12	0.11	1.28	0.79
Working							
capital	45	0.03	1.09	0.19	1.9	0.30	0.57
Financial							
structure	45	0.89	1.13	1.03	1.04	0.49	0.74
Capital		5.13	6.5	5.97	0.59	0.56	-0.39
adequacy	45						
Asset							
quality	45	0.06	0.08	0.07	0.06	0.51	0.74
Managemen							
t quality	45	0.10	0.13	0.12	0.03	-0.47	-0.78

The finding on table 4.2 indicates that the average ROA of the MFIs in Kenya for the considered study period was 0.12 (12%) with a standard deviation of 12% with a minimum ROA of 1% and maximum ROA of 38%. N is 45 meaning that the number of observations is 45 from 9 companies for 5 years' period of data from 2017 to 2021. The table 4.2 above also shows that, the average working capital for the 45 observation made from the nine companies from the year 2017 to 2021 is 0.19 with a high standard deviation of 1.9 with the minimum age being 0.03 and maximum of 1.09. Financial structure of these companies on average is



1.03 with a standard deviation of 1.04 varying from a low observation of 0.89 with a maximum of 1.13. The average capital adequacy for the observations is 5.97 measured by ratio of capital to total assets with a standard deviation of 0.59 varying from a range of lowest observation from a firm having 5.13 to one of the highest observation showing that 6.5. The average asset quality for the considered study period was 0.07 with a minimum and maximum asset quality of 0.06 and 0.08 respectively. The average management quality for the considered study period was 0.12 with a minimum and maximum management quality of 0.10 and 0.13 respectively. The kurtosis and skewness values range between the recommended ranges of -1 and +1 thus an indication the data is normally distributed.

### **4.3 Diagnostic Tests**

Since the data collected was over a time period of 5 years, there was a need to conduct diagnostic tests to establish whether it was free from multicollinearity and Autocorrelation before it was used to run a regression model. A variance inflation factor method was used to test for multicollinearity while Durbin Watson was used to test for Autocorrelation.

#### **4.3.1 Normality Tests**

The proper application of the parameters of inferential statistics the assumption of normality is tested. This is to ensure that the kurtosis and skewness of the data is tested. This is just to make a confirmation on whether the data under study is normally distributed. The data normality was then tested by use of Kolmogorov-Smirnov Test and the Shapiro-Wilk Test. The second method is best used when the sample of the data is small i.e. less than fifty. The method is much more reliable especially when making a determination on kurtosis and

skewness of the data. When the result is below 0.05, then it is slowly deviating from the distribution of the data that is normal.

**Table 4.2: Shapiro-Wilk Test of Normality**

Variables	Kolmogorov-Smirnov <sup>a</sup>			Shapiro-Wilk		
	Statistic	df	Sig.	Statistic	df	Sig.
ROA	0.278	45	0.357	0.675	45	0.413
Working capital	0.246	45	0.357	0.714	45	0.413
Financial structure	0.307	45	0.357	0.693	45	0.413
Capital adequacy	0.365	45	0.357	0.813	45	0.413
Asset quality	0.249	45	0.357	0.614	45	0.413
Management quality	0.643	45	0.357	0.647	45	0.413

In accordance to the results, the Kolmogorov-Smirnov tested significant values were at 0.357 for ROA of MFIs in Kenya, working capital, financial structure, capital adequacy, asset quality and management quality each. Shapiro-Wilk tested significant values were at 0.413 for ROA of MFIs in Kenya, working capital, financial structure, capital adequacy, asset quality and management quality. This brings an implication that the p-value is far much greater than the significance level of 0.05, hence the prediction that the data was normally distributed cannot be denied.

### 4.3.2 Autocorrelation Test

Autocorrelation tests were executed to check for connection of blunder terms across time-frames. Autocorrelation was tried by utilization of the Durbin Watson test. A durbin-watson measurement of 1.919 which is approximately 2, thus, it can be concluded that there was no autocorrelation in the data set.

**Table 4.3: Autocorrelation Test**

<b>Model</b>	<b>Durbin-Watson</b>
1	1.934

**Source; Researcher (2022)**

- a. Predictors: (Constant), capital structure, firm size, financial structure, asset management quality
- b. Dependent Variable: Financial stability of MFIs in Kenya

**4.3.3 Multicollinearity Test**

Multi-collinearity is the type of the test that makes an evaluation of whether the independent variable under the study is correlated or not. The multicollinearity test was done to check if the data have high correlation or are independent variable. The VIF was used to make an evaluation of how the variable correlate and the level of variance each variable has as a result of the dependence with the other variables. Upon the application of the rule of the thumb when VIF is bigger than 10 then there must be an existence of a great problem with the multicollinearity hence this is very dangerous to the research. The outcome of multicollinearity test was as presented in Table 4.4. Based on the study findings, tolerance values were above 0.1 and VIF values were below 10 implying that there was no evidence multicollinearity in the multiple regression model.



**Table 4.4: Variance Inflation Factor Test of Multicollinearity**

	Colinearity Statistics	
	Tolerance	VIF
ROA	0.514	1.946
Working capital	0.623	1.605
Financial structure	0.616	1.623
Capital adequacy	0.593	1.686
Asset quality	0.435	2.299
Management quality	0.603	1.658

**4.4 Correlation analysis**

Correlation was used to determine the strength of the connection among the variables. Table 4.7 shows the correlations.

**Table 4.5: Correlation Matrix**

	ROA	Working capital	Financial structure	Capital adequacy	Asset quality	Management quality
ROA	1					
Working capital	0.773	1				
Financial structure	0.460	0.316	1			
Capital adequacy				1		
Asset quality					1	
Management quality						1

Capital adequacy	0.618	0.163	0.216	1		
Asset quality	0.652	0.161	0.233	0.462	1	
Management quality	0.576	0.109	0.322	0.231	0.132	1

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Study findings presented in Table 4.5 established that, there is a significant positive relationship between financial stability of MFIs in Kenya and working capital ( $\rho=0.773$ ). Therefore, it can be implied that an increase in working capital is associated with increased financial stability of MFIs. Secondly, the findings showed that there is a weak positive significant relationship between financial stability of MFIs in Kenya and financial structure ( $\rho=0.463$ ). Also, there was a significant positive relationship between capital adequacy and financial stability of MFIs in Kenya ( $\rho=0.618$ ). Further, there was a significant positive relationship between asset quality and financial stability of MFIs in Kenya ( $\rho=0.652$ ). Finally, the findings showed that, there is a positive significant relationship between management quality and financial stability of MFIs in Kenya ( $\rho=0.576$ ).

#### 4.5 Regression Analysis

The relationship between financial management practices and the financial stability of MFIs in Kenya was established using multiple regression model after the diagnostic tests indicated that, the assumptions of multiple regression model would not be violated. Regression analysis involved the analysis of coefficient of determination, model significance and model coefficients.

Coefficient of determination indicates the percentage changes in the dependent variable that is explained by the independent variables in a regression model.

**Table 4.6: Model Summary**

<b>Model</b>	<b>R</b>	<b>R Squared</b>	<b>Adjusted Squared</b>	<b>R Std. Error of the Estimate</b>
1	0.889 <sup>a</sup>	0.790	0.753	0.896

Dependent Variable: ROA

Predictors: (Constant), working capital, financial structure, capital adequacy, asset quality and management quality

Table 4.6 indicates that, the coefficient of determination (R squared) was 0.790 which implies that 79% of the changes in financial stability of MFIs in Kenya is explained by working capital, financial structure, capital adequacy, asset quality and management quality.

The adjusted R square value of 0.753 revealed that, 75.3% of the changes in financial stability of MFIs in Kenya is explained by working capital, financial structure, capital adequacy, asset quality and management quality

**Table 4.7: ANOVA of the Regression**

	<b>Sum of Squares</b>	<b>Df</b>	<b>Mean Square</b>	<b>F</b>	<b>Sig.</b>
Regression	123.56	5	24.712	21.580	0.00003
Residual	44.66	39	1.1451		
<b>Total</b>	<b>168.22</b>	<b>44</b>			

Dependent Variable: ROA

Predictors: (Constant), working capital, financial structure, capital adequacy, asset quality and management quality

The study findings revealed that, the overall model was significant. The F statistic value of 21.58 was significant (Sig = 0.00003 < 0.05), hence an indication that, the model linking financial management practices to financial stability of MFIs in Kenya was significant.

The study also used the F-distribution table to obtain the F- critical value (F 0.05 (5,39) calculated at 5%, using denominator degrees of freedom of 39 and numerator degrees of freedom of 5 and compared against the F-calculated value of 21.58. The rule of the thumb is that if F-calculated is greater than the F-critical, then the model is significant. The F-critical value from the F-distribution table was 4.4638 which is less than 21.58 hence it confirms the previous findings that the model linking financial management practices to financial stability of MFIs in Kenya was significant.

**Table 4.8: Coefficient of Correlation**

	Un-standardized		Standardize	t	Sig.
	Coefficients		d		
	B	Std. Error	Beta		
(Constant)	3.77	0.451		8.359	0.000
Working capital	0.782	0.221	0.146	3.538	0.003
Financial structure	0.463	0.179	0.126	2.586	0.014
Capital adequacy	0.532	0.133	0.045	3.556	0.001
Asset quality	0.473	0.173	0.142	3.075	0.004



Management quality	0.549	0.2654	0.442	2.069	0.045
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a. Dependent Variable: ROA

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$$ROA = 3.77 + 0.782X_1 + 0.463X_2 + 0.532X_3 + 0.473X_4 + 0.549X_5 + \epsilon$$

From the finding in Table 4.8, the study found that holding working capital, financial structure, capital adequacy, asset quality and management quality at zero financial stability of MFIs in Kenya will be 3.77. It was established that a unit increase in working capital, while holding other factors (financial structure, capital adequacy, asset quality and management quality) constant, will lead to an increase in financial stability of MFIs in Kenya by 0.782 ( $p = 0.003$ ). Further, unit increase in financial structure, while holding other factors (working capital, capital adequacy, asset quality and management quality) constant, will lead to an increase in financial stability of MFIs in Kenya by 0.463 ( $p = 0.001$ ). Further, unit increase in capital adequacy, while holding other factors (working capital, financial structure, asset quality and management quality) constant, will lead to an increase in financial stability of MFIs in Kenya by 0.532. A unit increase in asset quality, while holding other factors (working capital, financial structure, capital adequacy and management quality) constant, will lead to an increase in financial stability of MFIs in Kenya by 0.473 ( $p = 0.023$ ). A unit increase in management quality while holding other factors (working capital, financial structure, capital adequacy and asset quality) constant, will lead to an increase in financial stability of MFIs in Kenya by 0.549 ( $p = 0.005$ ).

#### 4.6 Discussion of the Results

Results of the Pearson's correlation coefficient depicts that there is a significant positive relationship between financial stability of MFIs in Kenya and working capital. Therefore, it can be implied that an increase in working capital is associated with increased financial

stability of MFIs. In tandem with the study findings, Garrison (2017) noted 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.

Secondly, the findings showed that there is a weak positive significant relationship between financial stability of MFIs in Kenya and financial structure. Similar to the study findings, Owolabi and Inyang (2013) explain that some types of funds, like share capital and reserves owned fund, are held indefinitely by the business, while other types of funds, like long-term borrowings or debentures, are held for a longer period of time and still others are in the nature of short-term borrowings. A company's financial structure, which includes the sum of all these parts, is what really finances the business.

Also, there was a significant positive relationship between capital adequacy and financial stability of MFIs in Kenya. Similar to the study findings, Nestor, Leonard, and Okoye (2017) opined that there is strong evidence from cross-sectional research that capital sufficiency improves commercial = financial performance. Capital adequacy was analyzed in relation to financial performance for a sample of publicly traded Nigerian deposit money banks between 2010 and 2015. Financial results were shown to be positively correlated with capital

adequacy levels. Finally, the study showed empirical support for the hypothesis that capital sufficiency affects the financial performance of deposit money banks at the (5%) level of significance.

Further, there was a significant positive relationship between asset quality and financial stability of MFIs in Kenya. In line with the study findings, Ombaba, (2013) opined that the quality of an institution's assets has a significant impact on its performance since it affects interest earnings and, at the same time, lessens the weight of bad debts management costs required by regulation. To cover potential losses from loan defaults, banks must maintain cash reserves, the cost of which may be deducted from their profits. It is envisaged that the trade-off between asset quality and financial performance would be unfavorable if the NPA ratio to gross/net assets book is high.

Finally, the findings showed that there is a positive significant relationship between management quality and financial stability of MFIs in Kenya. Similarly, Sufian and Chong (2009) established that poor profitability is mostly caused by careless handling of costs. The literature on bank performance indicates that the efficiency of management may be gauged in part by how effectively it keeps operational costs in check. According to Mathuva (2009), local banks' Cost Income Ratio (CIR) is high in comparison to banks in other countries, hence they need to cut expenses in order to compete internationally. High interest rates in Kenyan banks are investigated by Beck and Fuchs (2004).





## CHAPTER FIVE: CONCLUSIONS AND RECOMMENDATIONS

### 5.1 Introduction

This section summarizes the research results, conclusions and research recommendations. The research finally indicates the limitations and areas which may require additional research.

### 5.2 Summary of the Findings

The aim of this research was to explore the effects of financial management practices on the financial stability of MFIs in Kenya. The finding established that, there is a significant positive relationship between financial stability of MFIs in Kenya and working capital. Therefore, it can be implied that an increase in working capital is associated with increased financial stability of MFIs. Secondly, the findings showed that there is a weak positive significant relationship between financial stability of MFIs in Kenya and financial structure. Also, there was a significant positive relationship between capital adequacy and financial stability of MFIs in Kenya. Further, there was a significant positive relationship between asset quality and financial stability of MFIs in Kenya. Finally, the findings showed that there is a positive significant relationship between management quality and financial stability of MFIs in Kenya.

The study established that, the average ROA of the MFIs in Kenya for the considered study period was 0.12 (12%) with a standard deviation of 12% with a minimum ROA of 1% and maximum ROA of 38%. N is 45 meaning that the number of observations is 45 from 9 companies for 5 years' period of data from 2017 to 2021. The table 4.2 above also shows

that, the average working capital for the 45 observation made from the nine companies from the year 2017 to 2021 is 0.19 with a high standard deviation of 1.9 with the minimum age being 0.03 and maximum of 1.09. Financial structure of these companies on average is 1.03 with a standard deviation of 1.04 varying from a low observation of 0.89 with a maximum of 1.13. The average capital adequacy for the observations is 5.97 measured by ratio of capital to total assets with a standard deviation of 0.59 varying from a range of lowest observation from a firm having 5.13 to one of the highest observation showing that 6.5. The average asset quality for the considered study period was 0.07 with a minimum and maximum asset quality of 0.06 and 0.08 respectively. The average management quality for the considered study period was 0.12 with a minimum and maximum management quality of 0.10 and 0.13 respectively.

### **5.3 Conclusions**

The study concluded that working capital has a positive and significant effect on financial performance of the MFIs in Kenya. The study further established that financial structure significantly and positively affected the financial performance of the MFIs in Kenya in Kenya. High financial structure is necessary and makes it obvious for MFIs to enhance their ability to create wealth.

The study concluded that capital adequacy has a positive and significant effect on financial performance of the MFIs in Kenya. Capital adequacy allows a financial institution to increase the potential gains or losses on a position or investment beyond what would be possible through a direct investment of its own funds. Based on the findings, the study concluded that asset management quality has a positive and significant effect on financial performance of

the MFIs in Kenya. A firm is highly competitive when as its managers are able to mix tangible and intangible assets in the most effective and efficient manner.

#### **5.4 Recommendations**

The outcomes of the research are analyzed, and many different suggestions are offered as a result. To begin, the research concluded that the use of sound financial management procedures has a materially favorable impact on the degree to which MFIs are able to maintain their financial viability. According to the findings of the research, managers working for microfinance institutions (MFIs) should provide a high level of priority to financial management practices while developing organization strategies. This will improve the company's financial operations by increasing their openness, accountability, and consistency. Nevertheless, the research suggests that management should give great consideration to the architecture of their own organizations before implementing financial management strategies. Because businesses have varying financial structures, this will help guarantee that the procedures that are implemented are appropriate for that specific company. The research also suggests that regulatory bodies should develop appropriate policies and regulations in order to make it easier for businesses to put financial management practices into practice. This recommendation is included in the study. The administration of microfinance institutions (MFIs) will become more efficient and effective as a result of this, and the use of best practices in financial management will become more consistent.

#### **5.5 Limitations of the Study**

The variables of this research were working capital, financial structure, capital adequacy, asset quality and management quality and financial stability measured using return on assets.



The conclusions are hence predicated on those factors as well as the particular measures that were chosen in order to predicate those variables. The research only focused on five different financial management practices, omitting many others that could be considered to be good financial management practices. These practices could have had an impact on the overall model and explained more variations in firm financial performance had they been included. The research also did not collect any market-related data, which prevented it from providing a true picture of the dynamic nature of market activities.

In its analysis, the research took into account annual data for the period of five years beginning in 2017 and ending in 2021. The duration of the research was five years, which is not enough time to arrive at a definitive verdict about the topic.

The results and conclusions are based on the study period that was evaluated rather than any preceding period. This is due to the fact that the methods of financial management are always evolving from year to year. In conclusion, the research relied on secondary data, which are by definition historical in character.

### **5.6 Suggestion for Further Research**

Despite the study's objective been accomplished, there are certain areas which are still demanding requiring further research. To begin with, the study only investigated five variable namely; working capital, financial structure, capital adequacy, asset quality and management quality.

In order to enable comprehensive determination of the phenomenon that exists, the study suggests that further study should be conducted, investigating other financial management practices such as retained profits, accountings and fixed asset management which have not been covered by the study.



The study was focused entirely on the deposit taking MFIs in Kenya. In order to improve on external validity in terms of generalization of the study findings, it is recommended that this study be replicated in MFIs drawn from other sectors. This will enable confirming as to whether the same positive relationship exists. Additionally, further study may be conducted taking consideration of other factors affecting the financial stability of MFIs such as the macroeconomic variables which exert a moderating effect on the relationship that exists.

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## APPENDICES

### Appendix I: List of Deposit-Taking Microfinance Institutions in Kenya

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

Source: Central Bank of Kenya website (2021)