EFFECT OF DONOR FUNDING ON FINANCIAL PERFORMANCE OF MICRO-FINANCE INSTITUTIONS IN KENYA

BY

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DECLARATION

This research project is my original work and has not been submitted for the award of a degree or any other qualification in any other university.

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This research project has been submitted for examination with my approval as the University Supervisor.

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DEDICATION

I dedicate this study to my entire family for their unwavering moral and financial support and their patience. To my dear friends as well for their moral support

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ABBREVIATIONS

CBK	Central Bank of Kenya
CGAP	Consultative Group to Assist the Poor
DTM	Deposit Taking Microfinance
MFI	Micro Finance Institutions
MIX	Microfinance Information Exchange
NGO	Non-Governmental Organizations
NSE	Nairobi Securities Exchange
ROA	Return on Assets
ROE	Return on Equity
SEA	South East Asia

ABSTRACT

The extraordinary dependence on donor capital influences microfinance, where financial performance and sustainability is essential. Adequate flows of donor assets are not an assurance for financial feasibility of MFIs. In Latin America and South Asia, the MFIs are well established but are challenged to improve their commercial feasibility. However, the emerging and donor dependent MFIs in sub-Saharan Africa strive to have a positive financial performance. The MFIs in Kenya offer much needed, but hitherto scarce, financial services to the financially excluded population. Over the years, microfinance institutions (MFIs) in Kenya have been enjoying subventions and donations from government and benefactors. However, donor capitals and government grants are falling short due to the latest global downturn. An information gap remains and thus the necessity to find out the impact of donor funding on financial performance of MFIs in Kenya. This study thus, pursues to answer the following study question: What is the effect of donor funding on financial performance of MFIs in Kenya? This descriptive cross-sectional survey research design was applied in the study. The fifty-seven microfinance institutions in Kenya formed the target population. This was a census study and therefore all the 57 MFIs in Kenya were selected to participate in the study, giving the study a sample of 57 MFIs. The researcher mainly drew data from secondary source. The secondary data was obtained from the published annual financial reports spanning for a period "t" spanning for five years (2011-2015). Quantitative data from mainly secondary sources was stored in a database and was analysed through descriptive statistics. Multiple regression analysis was used to assess the relationship between donor funding and financial performance of MFIs in Kenya. From the findings, the study concludes that donor funding contributes significantly to improvement in financial performance of MFIs. Donor funding significantly influences financial performance of MFIs. The MFIs financial performance has increased steadily over the study period. There has been a steady increase in amount of donor funding received by MFIs in Kenya. The study recommends that the banking industry regulator, the Central Bank of Kenya, should review donor funding to MFIs policy to ensure that MFIs have ease of access and that they increase their reach to the unbanked population. The management of MFIs should scale up their marketing and customer mobilization efforts to compete effectively with other financial institutions like commercial banks.

CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

MFIs are firms which were established set up to assist in funding the small scale micro-enterprises and local financial actions. The purpose was to put these small scale micro-enterprises and local financial on the map as they were occasionally disregarded from recognized finance and conventional banking practice. However, in Sub-Saharan Africa, microfinance has not become widespread and most low revenue earners, counting many of the deprived which is also seen in the poor access to finances by low income earners and business owners in the region. (CGAP, 2009; Spencer &Wood, 2005) Poverty and shortage of resources and funds is also extreme in the region (World Bank, 2009).

The microfinance sector has swiftly changed in the last years with very great payout of investment capitals or donors such as Omidyar and the Gates Foundation (Marek, 2014). Most MFIs have long only trusted on donors' monies to fund their progress. However, as a result of the affluent financial outcomes of some leading MFIs, donors are no longer the sole investors of the segment. Interested by the auspicious earnings and the optimistic view of the sector, some socially-oriented or profitable investors are eager to give their funds to the micro-finances as a way of boosting investment (CGAP, 2009 and World Bank, 2014).

Poorly trained workers, mismanagement, and incompetent governance and insufficient information management schemes all contribute to African MFI deficit

(CGAP, 2009). Despite these obstacles, the microfinance sector in Africa and Kenya in particular has developed both in size and in terms of monetary viewpoint with expansion partners recognizing as a key sector driving the financial development plan.

1.1.1 Donor Funding

Donor subsidy refers to progressive aid directed through financial organizations like MFIs (Spencer and Wood, 2005). For example, in 2008, OECD countries' governments used about US Dollars 135 billion on progressive aid (Agyemang, Awumbila, Unerman, & O'Dwyer, 2009). Donors' subsidies influence some core business choices of MFIs, even if these are not linked to better supervision performances. The microfinance sector has speedily changed during the last years and very huge payment of investment resources (World Bank, 2009).

NGOs have essentially become forces of alternative transformation. This has been caused by the perception that NGOs are the preferable vehicles for the channeling of developmental expenditure (Agg, 2006). Donor funding are mainly channeled through the IMF and with future prospects that more funding through the IMF will spur growth and financial returns (Hudon and Traća, 2008). Although donors are not competent in providing the requisite financial help, they are effective in ensuring effective use of the funds given by the IMF. This is done by checking on accountability and transparency in the use of the funds donated (Dixon et al., 2007).

According to World Bank, (2015) donor funding to the MFIs has been on the decline over the last ten years denying them the much need financial resources. This has largely been blamed on the global recession and the resultant financial restructuring

being undertaken by the global donors. Stewart et. al. (2010) further argues that the fact that donor funding is only channeled to the respective MFIs for several years without the assurance of continuation of funding once the funding period is over leading to the insufficiency of the funding over time. According to Baraza (2014) the financial support given to MFIs in Sub-Saharan Africa for the period between 2011 and 2015 declined by 25% representing a significant decline in donor funding.

1.1.2 Financial Performance

Financial performance entails ascertaining the achievement of financial goals (Al-Hussein et al., 2009). It can also be regarded as the process of assessing the outcome or success of a financial process. It is can also be used to assess and relate a company's financial growth and success over a period of time in comparison with other rival firms in an industry.

According to Crane (2010) the measures of firm financial performance are categorized into five groups including: financial efficiency, repayment capacity liquidity profitability and solvency. Measuring firm performance can also be achieved using the balanced scorecard which measures firm's learning and growth, internal business processes, financial performance and customer performance (Kaplan and Norton, 2001).

Financial performance is assessed by return on equity (ROE) and return on assets (ROA). The ROE measures accounting incomes for a retro per dollar of shareholders' equity capitalized. It is a creation of the profit margin and the asset revenue. Bank

productivity can be measured by the return on a bank's assets (ROA), a ratio of a bank's proceeds to its total assets. (Al-Hussein et al, 2009).

1.1.3 Donor Funding and Financial Performance

Donor funding is anticipated to be an amplified direct basis of funding which is factored either in capitalizing or financing undertakings of the firm being funded. Therefore, it is presumed that there is a direct connection between donor funding and organization performance (Bogan et al, 2007). Woller (2002) states that more funding leads to increased rivalry and also poses numerous risks for the investors and donor funders. One of the major triggers of this issue is that MFIs tend to favor the people in the poor communities and with small loan size as they hardly access funds Olivares-Polanco (2005) confirms trade-off between MFIs financial sustainability and depth of outreach as rivalry translates to and commercialization boosts loan amount, which ultimately leads to poor access to donor funds.

According to Michalski (2008) the push for a bank's portfolio policy demands an equal and balanced act between its cash and income. The liquidity management obliges that sufficient cash balances and other working capital assets are maintained in a balance. Further, adequate liquidity could assist a firm's fundamental aim of value development and boost of its value. According to Morduch (2005) MFIs have not worked properly to achieve independence from donors' funds or were not sufficiently encouraged to target self-sufficiency. The argument is that MFIs have not had enough incentives to properly act towards becoming independent from donors' money.

Hudon (2006) contends that while in the past, a few MFIs such as the Grameen Bank were only aiming operative sustainability than fiscal sustainability, few are still amenably considering donor subsidy in their long-term financial forecasts. This shift has happened partly due to the publication of the weak monetary results, and because of the clear move in the direction of fiscal sustainability. Good monetary performance is indeed produced principally by low operating expenses and efficient management procedures that take time to be developed.

Sanju (2014) posits that some MFIs working in rural areas with very poor clients, such as South East Asia, have been able to reach independence from donors. These MFIs have worked both on their costs and revenues. On the cost side, since transaction costs are very high, these MFIs are forced to improve their staff productivity but also to decrease staff salaries or hire less competent staff. Staff incentive schemes are one of the methods used by MFIs to improve their efficiency. On the revenue side of the income statement, product diversification and a better analysis of the demand has been largely developed (Cohen, 2003). Very high interest rates have also been charged by some MFIs where access to credit is the most significant matter.

According to Helms (2007) when working with very poor clients, MFIs are reluctant about increasing their interest rates to get higher margins because that would mean putting at risk their repayment rates. Thus, micro-lenders maintain interest rates at minimal levels with more grants and donor funding. Removing subsidies and donor funding affects the financial performance and viability of the MFIs and also put increasing pressure on fees charged to clients.

1.1.4 Micro-Finance Institutions in Kenya

Micro financial sector entails provision of monetary services to low wages clients; these services comprise savings and credit (Ledgerwood, Joanna, 1999). Micro-finance institutes in Kenya are grouped into three diverse classes; credit taking microfinance institutions, payment only non- deposit taking micro-finance institutes and casual organizations overseen by an exterior agency other than the government (Kimani, 2010). The establishment of microfinance institutions in the past using either an NGO or a saving and credit co-operative societies' model. The microfinance institutions have been a vital source of credit for low income persons and small medium businesses in the rural and urban areas of Kenya (CBK, 2015).

The micro finance sector has mostly been unregulated and was only regulated recently with the enactment of the micro finance Act 2006 (Wachiuri, 2012). The micro finance industry boasts the financial markets and expands access to financial services and products to a large number of Kenyans (CBK, 2015). The microfinance Act of 2006 obligatory regulates the microfinance sector. There are 9 licensed deposit taking microfinance institutions in Kenya as at December 2013. This phenomenon is relatively new in the country with the microfinance Act enacted in 2006 and operationalized in 2008 (CBK, 2015).

According to Central bank of Kenya (2015) the MFIs profit before tax increased from Ksh.823 million for the period ended December 2012 to Ksh. 1.2 billion for the period ended December 2013 while in 2014-2015, it grew to reach 1.5 billion. The branch network grew from 74 branches in 2012 to 91 branches in 2015 while the

marketing offices grew from 5 to 42. Out of the deposit base of Ksh. 24.7 billion, 37 percent comprised of cash collateral held by the DTMs as security for loans granted. Similarly, the size of net loan portfolio increased by 38.2 percent from Ksh. 19.9 billion in 2012 to Ksh. 27.5 billion in 2013 demonstrating increased demand for credit. The MFIs held total assets of Ksh. 41.4 billion, thus their significance in the economy cannot be overemphasized. At the same time donor funding channeled through MFIS in 2015 was Ksh.0.5 Billion. This performance is expected to continue as the institutions expand to serve the unbanked and under-banked Kenyan populace (CBK, 2015). The study will focus on all MFIs in Kenya.

1.2 Research Problem

According to Dixon et al., (2007) the extraordinary dependence on donor capitals is destructive to microfinance, where financial performance and sustainability is essential. The MFIs need not have a continuous peripheral push as donors' funding that funds their action is short term. World Bank (2009) argues that adequate flows of donor assets are not an assurance for financial feasibility of MFIs. MFIs need effective human and schemes bulk and decent governance that guarantees limpidity of processes and clear lines of culpability amongst shareholders in relation to MFI's mission. Further, MFIs has to adopt the current administration information models that are properly maintained by learning and accepting the use of business ethics. In Latin America and South Asia, the MFIs are well established but are challenged to improve their commercial feasibility. However, the emerging and donor dependent MFIs in sub-Saharan Africa strive to have a positive financial performance.

The MFIs in Kenya offer much needed, but hitherto scarce, financial services to the financially excluded population (FinScope, 2010; Mattoo and Payton, 2007). Over the years, microfinance institutions (MFIs) in Kenya have been enjoying subventions and donations from government and benefactors. However, donor capitals and government grants are falling short due to the latest global downturn. The falling government and donor funding is now trailed by a spiral growth of monetarily self-sustainable MFIs. This development has elevated the anxiety as to whether the societal objectives of traditional microfinance would be equally well boosted in the new situation in as much as financial performance and outreach contest with each other (Sanju, 2014). Kenyan MFIs' donor necessity has both sanguine and negative financial insinuations. The MFIs outreach is in Kenya has between two hundred and three hundred thousand active borrowers. 19 out of 25 licensed MFIs founded in the last 5 years have certainly been specifically consumer loaning based. Additionally, the space of services has also been chiefly narrowed, with little investments deployment to date.

A number of studies exist on contributor funding and MFIs. Sanju (2014) absorbed on financial performance of microfinance institutes and outreach to the poor in South Asia. The study exposed that alteration of grants and aids galloped MFIs into self-sustainable MFIs necessitates the investment from private sector. Coleman (2007) looked at capital structure and MFIs performance. Several crucial tendencies arose; the inclination towards improved leveraging of capital, the growth in rallying public credits as more MFIs get organized and a drift away from backed donor funds towards commercial funding Bogan (2007) while examining the ideal funding structure for

MFIs, exploited a panel data on MFIs. Using evocative statistics and modest regression models determined that the basis of funding MFIs affects the monetary performance of the institutions.

Kiogora (2000) did a study testing for disparities in the funding model at the NSE, he found out that the businesses listed at the NSE accepted various capital structure which were reliant on the firm category, scope of the firm and the cost-effectiveness of the firm. Baraza (2014) studied the association between funding model and financial performance of microfinance organizations in Kenya. The study revealed that funding model utilized by microfinance organizations affects the financial performance of the firm.

The aforementioned studies did not link donor backing to the monetary performance of MFIs in Kenya and where it was tried like Coleman (2007), the results need validation as they were done prior to global downturn which altered the donor funding. An information gap remains and thus the necessity to find out the impact of donor funding on financial performance of MFIs in Kenya. This study thus, pursues to answer the following study question: What is the effect of donor funding on financial performance of MFIs in Kenya?

1.3 Objectives

To establish the effect of donor funding on the financial performance of micro-finance institutions in Kenya.

1.4 Value of the Study

The study conclusions may be of boundless worth to the policy makers such as the donor societies and government as they pursue to endorse self-sustainable microfinance institutes in order to deliver long-term financial answers to the large pool of un-bankable.

The study findings may be valuable to the administration of MFIs by shedding light on the donor funding and its connection to their fiscal performance and inform their MFI commercialization efforts. The study will enable financial consultants offer prudent services to their clients as to the best funding sources for MFIs where financing is stable and the firm remains financially sound.

Moreover, microfinance planners, policy makers, and microfinance scholars taking a career in finance may also benefit. Scholars interested in carrying out further studies in the same area will find the results of this study useful since it forms basis for further research.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

The chapter presents the theoretical review and empirical literature on donor funding on financial performance of MFIs.

2.2 Theories

The study was guided by the theory of social capital, agency theory and life cycle theory.

2.2.1 Theory of Social Capital

According to Rankin (2002) social capital can be utilized to reduce poverty levels worldwide. Narayan and Pritchett (1999) argue that village's social capital has statistically significant social and causal effect on the income of the households. This shift has happened partly due to the publication of the weak monetary results, and because of the clear move in the direction of fiscal sustainability. Good monetary performance is indeed produced principally by low operating expenses and efficient management procedures that take time to be developed.

In microfinance, Group lending methodology has enabled low rates of default without collateral as it enhances social capital and builds new social capital among participants, which encourage microfinance (Feigenberg et al., 2010; Serageldin and Grootaert, 2000).

Serageldin and Grootaert (2000) insist that group-lending methodology uses social capital to overcome the issue of information asymmetry and credit history of borrowers in microfinance. Improvement in social capital through social interaction among clients motivate informal risk sharing among group members, which eventually decreases default rate of microfinance, and more frequent social interaction boosts economic cooperation among clients (Feigenberg et al., 2010). Cassar et al. (2007) also argue that relational social capital in the form of individual trust between persons and social homogeneity within groups has an optimistic effect on borrowing group performance.

2.2.2 Agency Theory

There is likely to be conflict of interest between the management of micro financial institutions and the social investors. As postulated by Jensen and Meckling (1976) agency costs usually arise from differing interest between debt holders and equity holders especially when there is the risk of default which according to Myers (1977) may result to underinvestment. In such a scenario, debt has negative effect on firm value. Jensen and Meckling (1976) argues that managers may for instance be given incentives. In this case, Williams, (1987) argues that higher leverage becomes useful as a governance mechanism to reduce wasteful cash flow by a threat of liquidation. Jensen (1986) further indicates that the other resultant effects may include higher pressure upon management to create cash flow to cover for interest expenses on the part of the debt.

The micro-finance institutions usually get grants and donor funding to finance change into deposit exploitation. Grant financing occasionally creates incentive challenges. The social investors and grant financiers usually aim at scaling up MFI market outreach. However, the management of the microfinance institutions strive for profit making. According to Cohen (2003) in microfinance sector, the agency costs are significantly high as the institutions are informational opaque.

Since MFIs are legal entities, the regulating agency may set minimums for parity investment as a mechanism to diminish extreme risk taking ultimately affecting the agency costs and altering MFIs' financing option impacting on the institution's productivity. According to Hudon (2006) micro finance institutions have access to grant funding and other net securities which are likely to enhance incentives for risk fluctuation or lax risk administration.

2.2.3 Life Cycle Theory

According to institutional life cycle theory framework of examination, majority of the microfinance institutions are initially NGOs with a social vision, funding processes with donations and concessional loans from benefactors. Therefore, empirical literature on microfinance mainly focus on NGO-MFI transformation‖ like a life cycle model (Helms, 2007).

According to Fehr and Hishigsuren (2004) the theory of life cycle indicates that the cradles of backing are linked to the stages of MFI expansion. Donor bequests and ―soft loans‖ include the mainstream of the backing in the determinative stages of the institution. As the MFI develops, private liability money becomes obtainable. In the

last phase of MFI evolution, traditional impartiality funding becomes accessible. There is increased rivalry in MFIs as they upsurge in number and recording a spread in directive enabling a change in the capital model of the industry (Farrington and Abrams, 2002).

2.3 Determinants of Financial Performance

The determinants reviewed included; asset quality, capital adequacy, management efficiency and liquidity management.

2.3.1 Capital Adequacy

Capital offers cushion against losses and thus it safeguards security and soundness of the financial organizations (Wachiuri, 2012). Banks capital generates liquidity for the bank due to the fact that securities are most delicate and prone to bank runs. In addition, greater bank capital lessens the casual of distress (Diamond, 2000). However, Beckmann (2007) argues that extraordinary capital lead leads to little profits since banks with a high capital ratio are risk-averse, they disregard possible (risky) investment prospects and, as a result, stockholders demand a lower return on their capital in exchange for lesser risk. All in all, banks need to uphold a lowest amount of capital to avert bank disaster.

According to Dang (2011), the adequacy of capital is adjudicated on the foundation of capital adequacy ratio (CAR). Capital capability ratio shows the interior ability of the bank to endure fatalities during disaster. Capital adequacy ratio is directly comparative to the pliability of the bank to crisis circumstances. It has also a direct

outcome on the success of banks by shaping its growth to risky but profitable undertakings or zones (Sangmiand Nazir, 2010).

2.3.2 Asset Quality

Asset superiority is one of the acute areas in defining the overall state of a bank. Loans are the most critical assets to any commercial bank since they comprise a majority of banks' assets and transmit the uppermost risk. In fact, Dang (2011) asserts that the highest threat facing a bank is the losses resulting from aberrant loans. According to (Sangmi and Nazir, 2010) banks ought to endeavor to keep the level of non-performing loans at lowest in order to recover monetary performance.

The quality of assets held by a bank relies on acquaintance to explicit risks, drifts in non-performing loans, and the health and productivity of bank debtors (Baral, 2005). Aburime (2008) emphasizes that the monetary performance of a bank depends on its aptitude to predict, avoid and monitor risks, perhaps to cover losses conveyed about by jeopardies arisen. The distribution of capitals also relates to the identification of the best areas to invest in an economy. Hence, in making decisions on the distribution of capitals to asset deals, a bank must take into consideration the level of risk to the possessions.

2.3.3 Management Efficiency

One of the major facets of measuring administration effectiveness of banks is to weigh the efficacy in cost supervision. Banks frequently try to retain their functioning costs (expenses) under control which is typically a substantial encounter with enlarged technology needs, IT management expenditure, regulatory acquiescence

necessities, competitive pressures and information security concerns (Berger and DeYoung, 2001). The Return on Revenue (ROR) was used to assess cost efficiency in this case for which increasing ROR depicted efficiency in cost management and decreasing ROR depicted inefficiency.

2.3.4 Liquidity Management

Liquidity denotes to the aptitude of the bank to accomplish its responsibilities when they fall due. According to Dang (2011) passable level of liquescency is definitely related with bank cost-effectiveness. Though, Molu (2012) discounts liquidity as a degree of virtuous performance since liquidity leads to minimal returns and therefore influences other facets of performance.

The trade-offs that commonly exist amid return and liquidity peril are established by detecting that a move from short tenure securities to lengthy term securities or loans increases a bank's return but also surges its liquidity menaces and the opposite is true. Thus, a high liquidity ratio shows a much less risky and less profitable bank (Hempel et al, 1994). According to Kamau (2010), the statutory least liquidity requirement is 20% in Kenya. However, the regular liquidity ratio was way above the least necessities between 2011 and 2015.

2.4 Empirical Review

A number of local studies exist on donor funding and MFIs. Kiogora (2000) did a study assessing for differences in the financing model at the NSE. The study established out that the businesses registered at the NSE assumed various capital

model which were reliant on on the industry grouping, scope of the firm and the effectiveness of the firm.

Okinda (2013) studied the accountability of donor funding by nongovernmental organisations in Kisumu County. The study established that donor funding was dependent on the accountability mechanisms put in place by the implementing NGO's. It was found out that NGOs were expected to keep a minimum set of financial statements. The study revealed that community involvement in oversight of NGOs was still not adequately practiced and that satisfaction of the employees with their pay perks could not be established. Donors were keen on compliance to the laws of the country and also involved the oversight bodies in checking compliance and legitimacy of the NGOs before funding and partnering with them. It was established that donors expected performance measurements to be done and that NGOs prepared specific reports. The donors also demanded that the financial statements authenticity be verified by independent auditors.

Baraza (2014) looked at funding structure vis vis MFIs financial performance. The study revealed that funding structure employed by microfinance institutions affects the financial performance of the firm. Debt to equity ratio has a negative correlation with financial performance meaning the more debt a firm employs in financing its operations the inferior financial performance it registers. Deposits to assets ratio has a positive correlation with financial performance implying that the more deposits a microfinance institution accepts the higher the financial performance. Loan portfolio has a strong positive correlation with financial performance meaning, a small increase in loan portfolio will lead to a higher increase in the financial performance.

Yvonne (2016) did a study on influence of micro finance services on growth of women owned enterprises in Kitui Central Sub-county. The access to loan facilities has the highest association with the growth of women business enterprises compared to the other variables. There was also a positive association between trainings and investment advisory service and microfinance institutions influence growth of women enterprises. The study established that the growth of women enterprises in Kitui Central Sub-county is due to changes in Microcredit, Micro savings and training/advisory services provided by MFIs.

Bogan (2007) investigated the prime funding model for MFIs for the period 2003 to 2006. Using panel data and descriptive statistics and simple regression models resolved that the basis of MFIs funding shakes the monetary performance of the institutions.

Holz (2002) found that funding model related absolutely with the firm performance, the result credits to the inclination of firm executives to fund their projects by borrowing and then use this cash optimally to exploit the performance. Therefore, if the banks want to give money, they will prudently study the practicability of the schemes that they want to finance precisely formerly offer loans until that the organizations can reach prerequisite returns to meet their responsibilities.

2.5 Conceptual Framework

In this study the dependent variable is financial performance of MFIs in Kenya. The financial performance of MFIs in Kenya is influenced by factors that constituted the independent variable. Based on the literature review, the independent variable is

donor funding. The financial performance of MFIs was measured using return on asset while donor funding was measured using the amount of funding received by the MFIs per year.

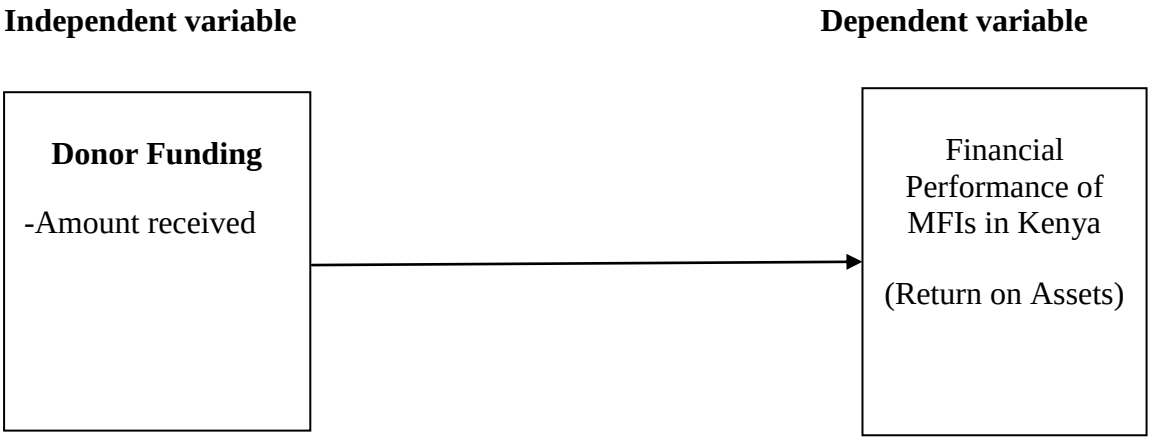

Figure 1 Conceptual Framework

2.6 Summary of Literature Review

The appraised local studies including; Okinda (2013), Baraza (2014), Yvonne (2016) and Owino (2015) did not concentrate on the effect of donor funding on monetary performance of MFIs in Kenya. For example, Okinda (2013) studied the responsibility of donor funding by nongovernmental organisations while Baraza (2014) studied the association between funding model and financial performance of MFIs. Meanwhile, Yvonne (2016) did a study on effect of micro finance services on evolution of women possessed enterprises. Henceforth a information gap still occurs on the consequence of donor funding on financial performance of MFIs in Kenya.

The global studies reviewed also did not pursue to find out the outcome of donor funding on financial performance of MFIs. Sanju (2014) focused on financial

performance of microfinance organizations while Coleman (2007) the influence of capital structure on the performance of microfinance institutes. Meanwhile, Bogan (2007) investigated the optimum funding structure for MFIs while Han-Suck Song (2005) examined funding structure bases of Swedish firms. Hence a knowledge gap still subsists on the influence of donor funding on financial performance of MFIs.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

In this section, the study methodology that was used in presented which entails research design, target population, data collection and data analysis.

3.2 Research Design

This descriptive cross-sectional survey research design was applied in the study. The study focused on all MFIs hence the design was the most appropriate. The further allowed the use of quantitative and qualitative approaches which allowed for collection of in-depth and complementing data.

3.3 Population

The fifty-seven microfinance institutions in Kenya formed the target population (CBK, 2015). This was a census study and therefore all the 57 MFIs in Kenya were selected to participate in the study, giving the study a sample of 57 MFIs (CBK, 2015). This is because the population of the study was small and therefore accessible (Kothari, 2004).

3.4 Data Collection

The researcher mainly drew data from secondary source. The secondary data was obtained from the published annual financial reports spanning for a period "t" spanning for five years (2011-2015) for the licensed MFIs in Kenya. It is during this period that donor funding registered the highest investment through the MFIs. The

study adopted panel data model in data collection and analysis. The researcher also collected primary data in the event that some of the MFIs had not disclosed data on donor funding and their financial performance. Using self-administered questionnaire, the researcher collected primary data which sought information from the finance managers of the respective MFIs.

3.5 Data Analysis

Quantitative data from mainly secondary sources was stored in a database and was analysed through descriptive statistics. The Statistical Package for Social Sciences (SPSS version 21.0) was used to manipulate the data. Measures of central tendency (mean), and measures of dispersion (standard deviation) (Kothari, 2004). Since the variables were in ratio scale Pearson's correlation analysis was applied to ascertain the relationship's magnitude between the dependent and independent variable. Multiple regression analysis was used to assess the relationship between donor funding and financial performance of MFIs in Kenya.

3.5.1 Analytical Model

The details of the analytical model were as follows; $Y=\alpha + \beta_1 X_1 + \beta_2 X_2 + \varepsilon$. Where;

Table 3.1 Study Variables

	Variables	Measure
Y	Financial performance	ROA (Return on Assets) = [net income / total assets] NB: Total net income of the MFIs
X_1	Donor funding	[total amount of donor funding received for period 2011-2015]
X_2	Control variable	Size of the MFI measured using total assets as natural logs (10^9)
ε	error term	
β	independent variable	

	coefficient	
α	Constant	

The value of the X_1; (donor funding) and X_2 was standardized by being expressed as natural logarithms.

3.5.2 Test of Significance

The study conducted test of significance using multiple regression analysis and t-test. To be statistically significant, the findings had to be within the 0.05 level of significance, and with a significance value smaller than 0.05 (Kothari, 2004).

CHAPTER FOUR: DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

The section entails the analysis, results and discussion on the effect of donor funding on financial performance of micro-finance institutions in Kenya. The secondary data of the 57 MFIs for the five year period (2011-2015) was used where financial performance was the dependent variable while the independent variable was donor funding.

4.2 Descriptive Statistics

4.2.1 Financial Performance of MFIs

The study dependent variable was financial performance of MFIs. The financial performance was measured using return on assets for the 57 MFIs for the five-year period between 2011 and 2015. The researcher used mean and standard deviation in order to meaningfully describe the study variables in Table 4.1 below.

Table 4.1 Financial performance (ROA)

Mean	Std. Deviation
1.03	5.082
1.39	5.923
1.65	5.692
1.95	6.042
2.03	8.016

In 2011 the ROA was 1.03 while in 2015 its value had increased to 2.03 from the findings, it is evident that there was 100% rise in ROA for the period between 2011 and 2015. This implied that the MFIs financial performance has increased steadily over the study period. Additionally, standard deviation that showed variation in financial performance between the 57 MFIs was of average 6.151. This was high indicating great variation in financial performance among the 57 MFIs.

4.2.2 Donor Funding

The study independent variable was donor funding which was measured using total amount of donor funding received by the MFIs each year for the period 2011-2015 expressed as a natural log (10^9).

Table 4.2 Donor funding

Natural logs (10^9)	Std. Deviation
0.103	6.076
0.192	7.074
0.294	7.067
0.397	8.066
0.502	8.065

The highest value of donor funding received by MFIs was valued at 0.502 billion in year 2015 while the lowest value of donor funding received by MFIs was valued at 0.103 billion in year 2011. This was 387.3% growth in donor funding to the MFIs in Kenya. Over the studied five year period (2011-2015) there has been a steady increase in amount of donor funding received by MFIs in Kenya. The same study period of 2011 to 2015 witnessed a steady increase in the financial performance of MFIs. This

implies that the donor funding received by MFIs contributed significantly to the increased financial performance of MFIs in Kenya. Thus, donor funding positively influenced the financial performance of MFIs in Kenya over the 5 years study period (2011-2015). On the other hand, the standard deviation which indicates variation in amount of donor funding received by MFIs was above 5 (average 7.269) implying high variation in amount of donor funding received by MFIs in Kenya.

4.2.3 Size of the MFIs

Size of the MFI as the study control variable was measured using total assets of the MFI per year for period between 2011 and 2015 expressed as natural logs (10^9).

Table 4.3 MFI Size

Natural logs (10^9) of total assets	Std. Deviation
2.02	5.066
2.33	5.056
2.7	6.057
3.2	5.059
3.5	5.058

The MFIs recorded improved performance in the year 2012, with total net assets registering an increase of 15.3 percent from Ksh. 2,020.8 billion (2011) to Ksh. 2,330.3 billion (2012). The same was the trend in 2013, where the total net assets recorded an increase of 16.0 percent from Ksh. 2,330.3 billion (2012) to Ksh. 2,703.4 billion (2013). In 2014, the MFIs registered higher performance, with total net assets recording an increase of 18.4 percent from Ksh. 2,703.4 billion (2013) to Ksh. 3,199.4 billion (2014). In addition, the MFIs registered higher performance in the year 2015,

with total net assets recording an increase of 9.17 percent from Ksh. 3,199.4 billion (2014) to Ksh. 3,492.6 billion (2015).

Thus there was a significant incease (73.3%) in the value of total net assets of MFIs between year 2011 and year 2015. The significant growth in value of total net assets of MFIs concides with the significant growth in their donor funding received by MFIs as well as growth in their financial performance. Thus, MFI size as a control variable positively influenced the financial performance of MFIs in Kenya over the 5 year period (2011-2015). The standard deviation which indicates variation in total net assets of MFIs of average 5.2592 is high indicating large variation in value of total net assets of MFIs in Kenya.

4.3 Correlational Analysis

Pearson's product moment correlation analysis was used to assess the relationship between the variables.

Table 4.4 Correlation Matrix

	Financial performance of MFIs in Kenya	donor funding	MFI size
Financial performance of MFIs in Kenya (r) (p) Sig. (2 tailed)	1.000		
Donor funding (r) (p) (2 tailed)	0.773 0.036	1.000	
MFI size (r) (p) Sig. (2 tailed)	0.463 0.018	0.316 0.047	1.000

Results of the Pearson's product moment correlation analysis depicts that there is a significant positive relationship between financial performance of MFIs in Kenya and

donor funding (rho=0.773, p-value <0.05). Therefore, it is implied that an increase in donor funding is associated with increased financial performance of MFIs in Kenya. Secondary, the showed that there is a weak significant positive relationship between financial performance of MFIs in Kenya and MFI size (rho=0.463, p-value <0.05). implying that an increase in MFI size is less associated with increased financial performance of MFIs in Kenya.

4.4 Multiple Regression Analysis

In determining the significance of donor funding on the financial performance of Kenyan micro finance institutions, multiple regression was applied with model as listed. $Y=\alpha + \beta_1 X_1 + \beta_2 X_2 + \varepsilon$ Where;

Where; Y= Financial performance, X_1= Donor funding, X_2 = MFI size, $\beta 0$ = is a Constant, ε= Error term, β= Coefficient of the independent variables.

Table 4.5 Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	. 899[a]	.8082	.796	0.0014

a. Predictors: (Constant), donor funding

b. Dependent Variable: financial performance of MFIs in Kenya

Table 4.4 above, shows that donor funding as the independent variable, explain 80.82% of variance in the financial performance of MFIs in Kenya as represented by the R^2. This means that other factors not studied in this research contribute 19.18% of variance in the dependent variable. Future, studies should investigate the role of these factors in influencing financial performance of MFIs in Kenya.

4.3.2 ANOVA (Analysis of Variance)

The results of Analysis of Variance are as tabled in Table 4.6 below.

Table 4.6 ANOVA (Analysis of Variance)

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	19.660	1	19.66	78.56	.001[a]
	Residual	7.007	56	.250		
	Total	26.667	57			

a. Predictors: (Constant), donor funding

b. Dependent Variable: financial performance of MFIs in Kenya

The significance value (P=0.001) was less than 0.05 therefore, the model is statistically significance. The F critical at 5% level of significance was 78.56. Since F calculated (value = 78.56) is greater than the F critical (3.23), the overall model was significant.

4.3.3 Coefficient of Determination

The regression coefficients of determination are as shown in Table 4.7 below.

Table 4.7 Regression Coefficients of Determination

Model	**Unstandardized Coefficients**		**Standardized Coefficients**	**t**	**Sig.**
	B	**Std. Error**	**Beta**	**B**	
(Constant)	4.432	.826		3.61	.000
Donor funding	0.752	0.1032	0.152	4.22	.0192
MFI size	0.545	0.2178	0.116	3.93	.0251

The regression equation; $Y=\alpha + \beta_1 X_1 + \beta_2 X_2 + \varepsilon$ becomes:

$$Y= 4.432 + 0.752\ X_1 + 0.545\ X_2 + \varepsilon$$

According to the regression equation above, taking donor funding to be constant at zero, financial performance of MFIs will be 4.432. In addition, a unit increase in donor funding will lead to a 0.752 increase in financial performance of MFIs while a unit increase in MFI size will lead to a 0.545 increase in financial performance of MFIs. Thus, donor funding contributes significantly to improvement in financial performance of MFIs. At 5% level of significance and 95% level of confidence, donor funding had a 0.0008 level of significance hence donor funding significantly influence financial performance of MFIs.

4.4 Discussion of Findings

The study revealed that MFIs financial performance increased steadily over the last 5 years where in 2011 the ROA was 1.03 while in 2015 its value had increased to 2.03 from the findings, it is evident that there was 100% rise in ROA for the period between 2011-2015. The findings are in line with CBK (2015) which indicated that microfinance sector recorded improved financial performance during the period ended December 2015.

It was established that there has been a steady increase in value of donor funding received by MFIs in Kenya from different sources such as government and international donors over the studied five-year period (2011-2015). The study found that donor funding received by banks significantly contributed to the improved financial performance of MFIs. Thus, donor funding positively influenced the

financial performance of MFIs. The study findings agree with Baraza (2014) who studied the association between funding model and financial performance of microfinance organizations in Kenya. The study revealed that funding model utilized by microfinance organizations affects the financial performance of the firm. The study established a positive relationship between funding structure and financial performance of MFIs. The findings however contradict with Dixon et al., (2007) who established that the extraordinary dependence on donor capitals is destructive to microfinance, where financial performance and sustainability is essential. The MFIs need not have a continuous peripheral push as donors' funding that funds their action is short term.

The study established that donor funding contributes significantly to increased financial performance of MFIs in Kenya, and that donor funding significantly affected the financial performance of MFIs in Kenya. The study findings are supported by Owino (2015) who established that there exists a positive relationship between financial performance and funding of commercial banks in Kenya as represented by the positive values of R 0.2252 at a confidence level of 95% meaning that 2.25% of financial performance is a function of funding. The findings disagree with World Bank (2009) which argues that adequate flows of donor assets are not an assurance for financial feasibility of MFIs. MFIs need effective human and schemes bulk and decent governance that guarantees limpidity of processes and clear lines of culpability amongst shareholders in relation to MFI's mission.

The study further established that the highest value of donor funding received by MFIs was valued at 0.502 billion in year 2015 while the lowest value of donor

funding received by MFIs was valued at 0.103 billion in year 2011. This was 387.3% growth in donor funding to the MFIs in Kenya. Over the studied five year period (2011-2015) there has been a steady increase in amount of donor funding received by MFIs in Kenya. The findings contradicts tha Sanju (2014) which indicated that donor capitals and government grants are falling short due to the latest global downturn. The falling government and donor funding is now trailed by a spiral growth of monetarily self-sustainable MFIs. This development has elevated the anxiety as to whether the societal objectives of traditional microfinance would be equally well boosted in the new situation in as much as financial performance and outreach contest with each other.

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

The section entails summary, conclusion and recommendations of the study on effect of donor funding on financial performance of micro-finance institutions in Kenya. The conclusions and recommendations are drawn from the study findings. The chapter is therefore structured into summary, conclusion, recommendations and areas for further research.

5.2 Summary

The study established that there was a steady positive increase in the ROA values by 100% over the 5-year period from ROA value of 1.03 in 2011 to 2.03 in 2015. Therefore, MFIs financial performance has increased steadily over the study period. The variation in financial performance of 57 MFIs was high at a standard deviation average value of 6.151.

The study established that the highest value of donor funding received by MFIs was valued at 0.502 billion in year 2015 while the lowest value of donor funding received by MFIs was valued at 0.103 billion in year 2011. This was 387.3% growth in donor funding to the MFIs in Kenya. Over the studied five year period (2011-2015) there has been a steady increase in amount of donor funding received by MFIs in Kenya. The same study period of 2011 to 2015 witnessed a steady increase in the financial performance of MFIs. Therefore, the amount of donor funding received by MFIs

contributed significantly to the increased financial performance of MFIs in Kenya. Consequently, the donor funding positively influenced the financial performance of MFIs in Kenya over the 5 years study period (2011-2015). On the other hand, the variation in amount of donor funding received by MFIs was above 5 (average STD dev=7.269) implying high variation in amount of donor funding received by MFIs in Kenya.

The study established that MFIs recorded improved performance in the year 2012, with total net assets registering an increase of 15.3 percent from Ksh. 2,020.8 billion (2011) to Ksh. 2,330.3 billion (2012). The same was the trend in 2013, where the total net assets recorded an increase of 16.0 percent from Ksh. 2,330.3 billion (2012) to Ksh. 2,703.4 billion (2013). In 2014, the MFIs registered higher performance, with total net assets recording an increase of 18.4 percent from Ksh. 2,703.4 billion (2013) to Ksh. 3,199.4 billion (2014). In addition, the MFIs registered higher performance in the year 2015, with total net assets recording an increase of 9.17 percent from Ksh. 3,199.4 billion (2014) to Ksh. 3,492.6 billion (2015).

Thus, there was a significant increase (73.3%) in the value of total net assets of MFIs between year 2011 and year 2015. The significant growth in value of total net assets of MFIs concides with the significant growth in their donor funding received by MFIs as well as growth in their financial performance. Thus, MFI size as a control variable positively influenced the financial performance of MFIs in Kenya over the 5 year period (2011-2015). On the other hand, the variation in total net assets of MFIs of average standard deviation value of 5.2592 is high indicating large variation in value of total net assets of MFIs in Kenya.

Results from Pearson's product moment correlation analysis showed that there is a significant positive relationship between financial performance of MFIs in Kenya and donor funding (rho=0.773, p-value <0.05). Thus, an increase in donor funding is associated with increased financial performance of MFIs in Kenya. Secondly, there is a weak significant positive relationship between financial performance of MFIs in Kenya and MFI size (rho=0.463, p-value <0.05) implying that an increase in MFI size is less associated with increased financial performance of MFIs in Kenya.

From the regression analysis, it was established that donor funding explained 80.82% of financial performance of MFIs (R^2). Again, taking donor funding to be constant at zero, financial performance of MFIs in Kenya will be 4.432. At the same time, a unit increase in donor funding will lead to a 0.788 increase in financial performance of MFIs while a unit increase in MFI size will lead to a 0.522 increase in financial performance of MFIs in Kenya. Therefore, donor funding contributes significantly to improvement in financial performance of MFIs in Kenya. Donor funding had a 0.0008 level of significance (>0.005) hence donor funding significantly influenced financial performance of MFIs in Kenya.

5.3 Conclusion

The study concludes that the financial performance of the MFIs has been on the increase over the last 5 years since 2011 to 2015 which was 100% rise in ROA for the period between 2011 and 2015 from ROA value of 1.03 in 2011 to ROA value of 2.03 in 2015. At the same period, there was great variation in financial performance among the 57 MFIs.

The study concludes that there was significant growth in donor funding received by MFIs in Kenya during the five-year period (2011-2015). With the highest value of donor funding received by MFIs was valued at 0.502 billion in year 2015 while the lowest value of donor funding received by MFIs was valued at 0.103 billion in year 2011 which was a 387.3% growth in donor funding to the MFIs in Kenya. The growth in donor funding happened concurrently with the improving financial performance of MFIs in Kenya.

Therefore, donor funding to the MFIs contributed significantly to increased financial performance of MFIs and donor funding positively influenced the financial performance of MFIs in Kenya over the 5 years study period (2011-2015). The variation in amount of donor funding received by MFIs in Kenya was high.

The study concludes that there was a significant increase in the value of total net assets of MFIs between year 2011 and year 2015. The significant growth in value of total net assets of MFIs concides with the significant growth in respective donor funding received by MFIs as well as growth in their financial performance. Thus, MFI size as a control variable positively influenced donor funding and ultimately the financial performance of MFIs. The total assets grew from 2.02 (year 2011) to 2.33 (years 2012), to 2.7 (year 2013) to 3.2 (year 2014) to 3.5 in year 2015. This was 73% growth in MFI size as a function of their total assets.

The study further concludes donor funding contributes significantly to improvement in financial performance of MFIs in Kenya as it brought about 80.82% of variance in the financial performance of MFIs in Kenya. Similarly, donor funding contributes

significantly to improvement in financial performance of MFIs and also significantly influenced financial performance of MFIs in Kenya.

The study also concludes that there is a significant positive relationship between financial performance of MFIs in Kenya and donor funding. Thus, an increase in donor funding is associated with increased financial performance of MFIs in Kenya.

5.4 Recommendations

The study confirmed that donor funding significantly influenced financial performance of MFIs. The study therefore recommends that the banking industry regulator, the Central Bank of Kenya, should review donor funding to MFIs policy to ensure that MFIs have ease of access and that they increase their reach to the unbanked population.

The study further recommends that management of MFIs should scale up their marketing and customer mobilization efforts to compete effectively with other financial institutions like commercial banks. This will increase their financial performance and at the same time attract more donor funding from the international partners and government based on their reach of the unbanked population.

From the findings, it was revealed that the size of the MFI which was the study control variable was correlated with the donor funding inflows and therefore also has an influence on the financial performance of MFIs. The study recommends that the management of the MFIs should seek to enhance the size of their total assets which determined the size of their MFIs to continue attracting increased donor funding.

5.5 Limitations of the Study

For the purpose of this study, the model used was quite simplified and might not have captured every important aspect that relates to the donor funding among MFIs. In addition, access to data was a challenge as the published financial statements of the MFIs failed to disclose some vital information required by the study forcing the researcher to look for alternative sources of data collection.

Another study limitation was the busy work schedule of the employees which limited their willingness to participate in the study. The data that was sourced using the data collection form required that the MFIs employees filled in the collection form. This meant for the creating extra time to respond to this inquiry amidst their daily routines.

At the same time some of the MFIs had in place the policy of non-disclosure of information. This meant that the researcher had to go through a rigorous process of approval before the data could be disclosed despite the study posing no reasonable threat to the MFIs as preconceived.

5.6 Areas for Further Studies

Further research should be conducted on challenges of donor funding among MFIs in Kenya. The study established that donor funding only explained 80.82% variance in the financial performance of MFIs in Kenya while other factors not studied contributed 19.18% of variance. Future, studies should therefore investigate the role of these other factors in influencing financial performance of MFIs in Kenya.

The study focused on all the 57 micro finance institutions as the unit of analysis. Though the findings were generalizable, they lack in depth understanding of the situation. Future study should consider doing a case study on one of the MFIs to gain an in depth understanding of the role of donor funding on the financial performance of MFIs.

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APPENDICES

APPENDIX 1: DATA COLLECTION FORM

	2011	2012	2013	2014	2015
Total assets					
Net income					
Total amount of donor funding received					

APPENDIX II: MICRO-FINANCE INSTITUTIONS IN KENYA

1. AAR Credit Services
2. ADOK TIMO
3. Agakhan Foundation Microcredit Programme
4. Biashara Factors
5. BIMAS
6. Blue Limited
7. Canyon Rural Credit Ltd
8. Caritas Microfinance
9. Century DTM Ltd
10. Co-operative Bank
11. ECLOF Kenya
12. Equity Bank
13. Faulu Kenya DTM
14. Focus Capital Limited
15. Fort Credit Limited
16. Fountain Credit Services Ltd
17. Fusion Capital Ltd
18. Greenland Fedha Ltd
19. Indo Africa Finance
20. Jamii Bora Bank
21. Jitegemea Credit Scheme
22. Juhudi Kilimo Co.Ltd
23. Kenya Agency for the Development of Enterprise and Technology (KADET)
24. Kenya Entrepreneurship Empowerment Foundation (KEEF)
25. Kenya Post Office Savings Bank (Postbank)
26. K-REP Bank
27. Kenya Women Finance Trust Limited (KWFT)
28. K-rep Development Agency
29. Micro Africa Kenya Ltd
30. Milango Financial services

31. Mini Savings & Loans Ltd
32. Molyn Credit Ltd
33. Musoni Kenya Ltd
34. Nationwide Credit Kenya Ltd
35. Ngao Credit Ltd
36. OIKOCREDIT
37. One Africa Capital Ltd
38. Opportunity Kenya
39. Pamoja Women Development Programme (PAWDEP)
40. Platinum Credit Limited
41. Rafiki DTM Limited
42. Remu DTM Limited
43. Renewable Energy Technology Assistance Programme(RETAP)
44. Rupia Ltd
45. Samchi Credit Limited
46. Select Management Services Ltd
47. SISDO
48. SMEP DTM
49. Springboard Capital
50. SUMAC DTM Limited
51. Taifa Option Microfinance Limited
52. U & I Microfinance Ltd
53. UWEZO DTM
54. Women Enterprise Fund
55. Women Enterprise Solutions
56. Yehu Microfinance Trust
57. Youth Initiatives-Kenya (YIKE)

Source (CBK, 2015).