# EFFECT OF QUALITY MANAGEMENT PRACTICES ON FINANCIAL PERFORMANCE OF MICROFINANCE BANKS IN KENYA

BY

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## DECLARATION

I declare that this dissertation is my original work and has not been previously published or submitted elsewhere for award of a degree. I also declare that this contains no material written or published by other people except where due reference is made and author duly acknowledged.

Student Name: _____ Reg,No. _____

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I do hereby confirm that I have examined the master's dissertation of

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And have certified that all revisions that the dissertation panel and examiners recommended have been adequately addressed.

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## DEDICATION

This research proposal is dedicated to my parents Mr. and Mrs. Kimemia, my boy Gavin and my lovely siblings Maurice and Maureen. Thank you my family.

# ACKNOWLEDGEMENT

I thank God for giving me this chance to be alive and well and also for giving me ideas for writing this dissertation. Thanks to my family for their undying support, love and care. I would also like to thank my supervisor, Dr. Okonga for your guidance throughout this period. I am also grateful to all my friends, classmates and everyone who one way or the other encouraged and supported me during this period. Finally, I thank the entire KCA university fraternity for providing a conducive environment for my academic work. God bless you all.

# ABSTRACT

Due to the changing financial needs, many people are now appreciating the importance of microfinance. There has been an increase in the number of microfinance banks in Kenya. However, the sector still falls short on attaining efficiency hence compromising on profitability. The main purpose of this study was to determine the effect of level of management quality on financial performance of microfinance banks in Kenya specifically. The objectives of the study were toidentify the extent to which staff training costs influence financial performance of microfinance banks in Kenya, establish the extent to which operational efficiency costs influence financial performance of microfinance banks in Kenya and establish the extent to which strategic planning costs influence financial performance of microfinance banks in Kenya. The study adopted a descriptive survey design. The population of study was 6 microfinance institutions that maintained audited financial statements. Through census sampling technique all the 6 microfinance institutions were considered for the study. Secondary data was obtained through desktop research on a predesigned data collection form. Descriptive statistics was used to analyze data. Moreover, Statistical Package for Social Sciences (SPSS) was used to give the statistics. A multiple regression model was employed to determine the relationship between the independent and dependent variables. The study established that staff training costs are significant factor that influences the financial performance of microfinance banks.Moreover, the study established that strategic planning costs and operational efficiency costs had significant effect on the financial performance of microfinance banks in Kenya; this implies that the two add on financial significance.

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# ACRONYMS AND ABBREVIATIONS

**AMFI:** Association of Microfinance Institutions

**CBK:** Central Bank of Kenya

**CEO:** Chief Executive Officer

**ESH:** Efficiency Structure Hypothesis

**GDP:** Gross Domestic Product

**MFB:** Microfinance Bank

**MFI:** Microfinance Institution

**MP:** Market Power

**NCBD**: Nairobi Central Business District

**NGO:** Non-Governmental Organization

**ROA:** Return on Assets

**ROE:** Return on Equity

**SCP:** Structure Conduct Performance

**SME:** Small and Medium sized Enterprise

**TQM:** Total Quality Management

**ANOVA**: Analysis of Variance

## CHAPTERONE

## INTRODUCTION

### 1.1 Background of the Study

Microfinance is the business of offering financial services to low income earners. Microfinance can be defined as accepting and lending money to small/micro enterprises and low income earners, payable on demand or at an agreeable future date (Microfinance Act, 2006). Microfinance activities date back to the 1970s where credit facilities were provided to poor farmers by government agencies and international donors and as a way of enhancing agricultural production. In the mid-1980s, the microfinance sector began to incur losses and insufficient capital inhibited its operation. This therefore necessitated the need for a sustainability of such that microfinance was integrated with the financial system as a whole (Ledgerwood, 2013). Since then microfinance has expanded tremendously.

Due to the changing financial needs, many people are now appreciating the importance of microfinance. Initially microfinance focused on lending to groups, a concept that was successfully implemented by Grameen Bank in Bangladesh(Chowdhury 2009). Later on, there was a shift to individual lending due the fact that group lending was difficult to apply in urban areas and the wealthier borrowers preferred individual contracts. The role of microfinance is increasingly becoming pivotal due to changing legislations, increased compliance requirements and increased awareness. Programs such as Africa Microfinance Growth Centre, a partnership of Unitus (an international non-profit organization) and FSD, have been established to provide support and training for MFIs at their initial stages of their establishment (FSD, 2010). In Kenya, Association of Microfinance Institutions (AMFI) is the voice of microfinance institutions.

An international financial crisis that occurred in 2007 caused a major mishap of MFIs leading to a decrease in profits as well as asset growth rates. Nevertheless, the microfinance industry has managed to grow with the motivation of factors such as technology innovation, expanded funding sources and diversification of microfinance providers (Ledgerwood, 2013). Currently, loan portfolios from MFIs are estimated to have a growth of 20% per year globally (FGDA, 2014). A great milestone in the Kenya's microfinance sector has been the operationalization of the Credit Information Sharing System that begun in 2009 and allows for credit scoring thus debtor's information processed within a period of time can be analyzed to determine a customer's credit worthiness (AMFI-K, 2014).

Studies have shown that a number of customers are still not able to access formal services. FSD (2009) reveals that 35.9% of Kenya's rural population does not have access to formal financial services. In addition, AMFI (2013) notes that the highest concentration of MFIs is found in Nairobi and Kiambu counties having an average of 16 microfinance institutions while the lowest concentration of MFIs being in the North and North East regions each having an average of 3 MFIs. Currently, there is still a geographical bias in microfinance in that most operate in urban areas. There is possibility for more growth in Africa's microfinance sector due to the culture of informal saving, the presence of a large population of poor people and support obtained from international donors such as World Bank and IMF (Paye, 2012). FSD (2010) emphasizes that growth and development of an MFI is dependent on the competency of management.

### 1.1.1 The Concept of Microfinance Bank

A Micro-finance bank is an institution that provides such services as savings accounts, loans, insurance, money transfers and other banking services to customers that lack access to traditional financial services. It is also known as microcredit.The concept of microfinance

originated in the 1980s with the start of Grameen Bank in Bangladesh. Grameen Bank was founded by Professor Mohammed Yunus with an attempt to reduce the levels of poverty in Bangladesh (Chowdhury, 2009). Mr. Yunus was later acclaimed as the Nobel Peace Prize in 2006 following the establishment of the Bank. Microfinance was introduced to provide for the financial needs of people at even the smallest scale possible in both developed and developing countries (Brune, 2009). Microfinance is a means by which the poor can be economically productive and therefore enhancing economic development.

Grameen Bank is popular with the successful implementation of group-lending system where it proposes various indicators that measure the effectiveness of eradication methods. Such indicators include the financial situation as well as the basic needs of the poor (Brune, 2009). Brune (2009) notes that group-lending involves peer pressure and social selectivity to hedge against default risk as well elevating the rates of repayment. No group is usually willing to take in a member who engages in high risk behavior or one whose reputation is doubtful (Brune, 2009). Ledger wood (2013) notes that different risks are associated with different products thus it is necessary to diversify the microfinance institutions bringing up the issue of financial inclusion.

Microfinance is a globally accepted tool for poverty reduction and financial inclusion (Wambugu and Ngugi 2012). Financial inclusion refers to a state where low income households have access to timely and sufficient credit at affordable prices (Paye, 2012). In Kenya, microfinance institutions can be classified as formal, semi-formal or informal. Formal institutions are those which have been licensed under the Banking Act of Kenya while the informal class consists of all microfinance operators that have not been licensed under the Banking Act. Semi-formal institutions also known as credit- only institutions and include Microfinance banks.

## 1.1.2 Financial Performance

Financial performance is a measure of how well a firm is utilizing its resources to realize its financial goals, within a given time frame. It is determined by analyzing data obtained from financial statements prepared in accordance with generally accepted accounting principles (Schonbohm, 2013). Such data is obtained from the income statement, balance sheet and cash flow statement. Financial performance is useful in determining the financial health of an institution and for comparison with other institutions within the same industry or across different industries (Trivedi, 2010).

The performance of microfinance banks in terms of profitability can be assessed by determining the Return on Equity, Return on Assets and Net Interest Margin ratios can be measured using as described below. Return on Equity is used to measure the profitability of both microfinance banks and commercial banks. It is the rate of return of income as a percentage of shareholders' equity. It is the amount of profit earned compared to total shareholders' equity (Ongore and Kusa, 2013). ROE gives the amount of profit generated by company in comparison to the shareholder's investment (Narwal et al, 2015). The situation is likely to be that higher the ROE, the higher the profitability of the bank.

Return on Assets is net income over total number of assets. Narwal et al (2015) denote ROA as operating income divided by total assets. It is the rate at which MFI uses its assets to generate income and usually excludes taxes, donations as well as non-operating items (Bruett et.al, 2005). It measures the efficiency of the management by determining whether resources have been efficiently utilized to generate revenues (Ongore and Kusa, 2013). A higher ROA shows that a bank has high efficiency.

Net Interest Margin is the difference between the interest revenue acquired by a bank and the interest expense paid for by it. It is expressed as a percentage of a bank's earnings on loans and other assets over a given period of time less the interest paid on loans divided by average earning assets. A number of internal and external bank factors can be used to determine the interest margins of banks. Internal factors include loan quality, credit activity, credit risk, and bank size and ownership structure among other while the external factors include real GDP growth and rate of inflation.

### 1.1.3Financial Performance of Microfinance Banks in Kenya

Microfinance banks affect the economic growth and development of a country. According to Narwal, Pathneja and Yadav (2015), the performance of the microfinance institutions affects the banking sector which in turn affects the performance of the economy as a whole. Despite an increase in profitability in the Kenyan banking sector from the year 2000, only a few of the banks are considered to be profitable (Olweny and Shipho, 2011). Too much profitability is not considered to be necessarily good as it could be an indicator of market power from larger banks since such banks could charge high interest on loans and give lower returns on deposits. On the other hand, low profits discourage shareholders and depositorsfrom banking thus banks have less capital to operate.

Like most institutions, microfinance banks are interested in determining their profitability, efficiency and solvency to analyze performance. Financial ratio analysis is commonly used to establish these aspects of performance as opposed to use of econometric techniques (Schonbohm, 2013). Financial analysis involves examining past and current financial data so as to compile information necessary for management decisions. It is described as the assessment of profitability, productivity, liquidity, working capital, fixed assets, social and fund flow performances (Njiru, 2014).

Profitability is the main determinant of performance of banks since it is the primary goal of every business (Ongore and Kusa, 2013). Bank profits are essential in providing a source of equity if they are ploughed back into the business. Njiru (2014) further notes that firms often use ROE, ROA and NIM as the profitability measurement ratios. Efficiency can be measured using operating expense ratio while a firm's solvency can be determined using debt equity ratio (Gatuhu, 2013). The ratios that could be used to determine a firm's solvency include current ratio, quick ratio, times-interest –earned ratio and debt ratio (Schonbohm, 2013).

In Sub-Saharan Africa, Kenya tops the list in being the most vibrant in the microfinance sector due to the fact that it has a larger network of branches and wide variety of institutions (MIX, 2011; Wambugu and Ngugi 2012). The number of gross loans of DTMs stood at Ksh. 40.8 billion in March 2015 while the gross loans' figure was Ksh 40 billion in December, 2014. This change represented an increase of 2% which translated to a good performance. Moreover, the long term loans granted in 2014 were valued at Ksh 6.9 billion compared to Ksh 4.9 billion translating to a decrease of 29% (CBK, 2015).

In March 2015, the number of the deposit accounts in the microfinance banks was 2,310,742 compared to 2,254,591 in 2014 thereby recording a 2.5% growth (CBK 2015). The increase was deemed a result of increase in deposit mobilization. The value of loan accounts decreased from 457,631 in 2014 to 440,517 in March 2015 (CBK, 2015). This was attributed to the merging of existent loan accounts which was necessary as a result of inception of new products. CBK (2015) further noted that the total unaudited pre-tax profits were Kshs 37.3 billion in March 2015 compared to 33.4 billion for March 2014 recording a growth of 11.6%.

### 1.1.4 Quality Management Practices

Management is the proper utilization of resources so as to achieve the goals of an organization. It incorporates planning, organizing, controlling, coordinating and staffing functions. Management quality is a component used in the CAMEL rating system, which traces its roots to the Federal Financial Institution Examination Council. The council adopted the system on 13 November 1979 followed by the National Credit Union Administration which adopted it in October 1987 (Dang, 2011). CAMEL is an acronym for five components where C represents Capital adequacy, A stands for Asset quality, M stands for Management, E stands for Earning ability and L stands for Liquidity. It is used to assess the financial health conditions of financial institutions (Dang, 2011).

Uniform Financial Institutions Rating System (1997) defines management component as "the capability of the board of directors and management, in their respective roles, to identify, measure, monitor, and control the risks of an institution's activities and to ensure a financial institution' safe, sound, and efficient operation in compliance with applicable laws and regulations as reflected in this rating". These risks range from legal and compliance risks to market risk. Directors are responsible for determining the strategic goals and policies of an institution. They also provide oversight to an institution while the senior management develop and implement the institution's objectives and policies respectively.

According to Dang (2011), institution's size, the history of operations and structure of ownership are relevant in describing the management quality component of the CAMEL model. Managerial skills and experience, adequacy of internal controls, adequacy of audit program, conformance to policies and risk management activities are elements used to determine the capability of management (Uniform Financial Institutions Rating System, 1997). In addition, Ongore and Kusa (2013) notes that the assessment of staff quality, internal

control environment and management systems helps in the evaluation of managerial performance.

**1.2 Statement of the Problem**

Despite the many microfinance banks coming up in the market, some are still going under. Many institutionsare focusing on management although poor management can still be witnessed in some organizations. Microfinance banks in Kenya still fall short on attaining efficiency hence compromising on their performance. A myriad of reasons has been given as to why a bank could be successful. One of the justifications of the success is that leadership is important to high performance, while to other researchers it is the history of operations, size of institution, capital access, technology advancement and asset quality that influence performance. According to (FSD, 2010) an organization's success depends on its employees. Furthermore (Waithaka, Gakure and Wanjau, 2013) note that the governance of a microfinance institution is important in enabling it to stick to its mission.

Strategic leadership is a challenge to MFIs, not only in Kenya, but also to the whole of East Africa. The CEOs, Board of Directors as well as Management of financial institutions do not possess adequate training and necessary skills needed to meet the daily challenges that arise in the process of achieving organizational goals (FSD, 2010).Management capacity has been noted to be a key constraint facing the growth and development of the microfinance industry (AMFI-K, 2013).Therefore, there is need for the development of strategic leadership so as to promote their growth which will, in turn help to achieve the overall goal of ensuring the financial needs of low income households are met (FSD, 2010).

Many studies done in Kenya have been presented with regards to the effect of factors such as capital structure and liquidity that affect financial performance of financial institutions

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mainly focusing on overall banking sector, but little research has been undertaken on microfinance institutions. Mulunga (2010) carried out a study to identify the problems that impact the growth of microfinance institutions in Namibia. The study found out that inadequacy of capital, high costs of operation and lack of regulation inhibit growth of Namibian MFIs. The study recommends that the MFBs address these problems so that they can become efficient.Ongore and Kusa (2013) did a study on the determinants of financial performance of Kenyan commercial banks and found out that management efficiency/quality significantly influences financial performance of banks. Another study was conducted by Kamau and Were (2013) to analyze the driving factors behind the banking sector performance in Kenya from 1997 to 2011. The study used SCP and ESH; and data envelopment analysis to get efficiency scores. They found out that structure power has a greater effect on Kenyan banking sector performance as compared to ES power and recommended increasing operational efficiency to reduce competition.

Muia (2014) conducted a study on the effects of TQM implementation in performance of microfinance institutions in Kenya focusing on K-rep development agency. It was concluded that organizations were not realizing excellent performance levels. It was further noted that little attention had been given to leadership and employee involvement in organizations even though it was considered an influence to performance. There has been no study conducted to establish the effect of management quality on the financial performance of microfinance banks. Therefore, this study seeks to bridge this gap and thus determine the effect of level of management quality on the financial performance of microfinance banks in Kenya.

### 1.3 Objectives of the Study

The main objective of this study is to establish the effect of management practices on the financial performance of Microfinance banks in Kenya by seeking to:

i. Identify the extent to which staff training costsinfluence financial performance of microfinance banks in Kenya.

ii. Establish the extent to which operational efficiency costs influence financial performance of microfinance banks in Kenya.

iii. Establish the extent to which strategic planning costsinfluence financial performance of microfinance banks in Kenya.

## 1.4 Hypothesis Testing

The research will endeavor to answer the following questions;

$H0_1$. Staff training costs have no significant influence onfinancial performance of microfinance banks in Kenya

$H0_2$. Operational efficiency costs haveno significant influence onfinancial performance of microfinance banks in Kenya

$H0_3$. Strategic planning costs have no significant influence on financial performance of microfinance banks in Kenya

## 1.5 Significance of the Study

The research will contribute recent statistics that can be used by the government in improving performance of microfinance. The government would then use the statistics to come up with necessary policies, procedures and regulations that would uplift MFI operations as well as performance. Also, the research will add on to the existing information in respect to the microfinance industry. It will either clarify affirm or reject existing theories and concepts of microfinance and identify areas that require further research and thus stimulate new research. The study will also determine whether indeed microfinance serves its purpose of reduction of poverty and addressing financial inclusion.

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The research will help in creating awareness on the existence of particular services. The target population of low-income households and SMEs will be able to make decisions concerning their investments, savings and loans. These potential customers will be enlightened on matters such as the specifications for consideration of clientele used by MFIs and also affordable terms of credit as well as the options in which they can manage their funds within the MFIs. Moreover, the study will help microfinance institutions to determine their weaknesses and thus device ways in which they can improve on performance. These microfinance institutions will then be able to determine the training needs of the management team as well as establish the areas needed to focus on so as to improve performance.

Lastly, the research will enable institutions to identify customer needs thereby allowing the MFIs to address the issues that require solving and improve on service delivery. This will help to improve customer satisfaction and thus retain customers as well as attract new ones. This will, in turn increase the use of financial services of MFIs thereby increasing their profitability. It is also important to note that having this information available to the MFIs will reduce the costs that they would have incurred to conduct market research and can thus maximize their revenues hence better performance.

**1.6 Basic Assumptions**

Simon (2011) explains that assumptions are situations in the study that area little out of control but are still necessary so as to make the research study to be relevant. The study makes the following assumptions:

i.   That the information will be truthful and reliable.

ii.  That the research will adequately address the problem of inefficiency in management and will derive possible solutions to ensure better growth and profitability of microfinance

institutions. This assumption is made on the basis that a pilot study would be conducted before the actual study.

## CHAPTER TWO

## LITERATURE REVIEW

### 2.1 Introduction

The chapter is devoted to reviewing literature to the current study on level of management quality in relation to financial performance. It will give a review of empirical and theoretical literature as well as a conceptual framework and finalized with a research gap.

### 2.2 Theoretical Literature

This section presents all applicable theories relevant to the current study of the concept of management quality in relation to financial performance. The theories are important to this study because they provide valuable information with regard to how different management quality components influence the financial performance of microfinance banks. These theories are Scientific Management theory, Efficiency Structure theory, Market-power theory and Expense - Preference Behavior theory discussed as follows:

### 2.2.1 Scientific Management Theory

Scientific Management theory was invented by Fredrick Winslow Taylor in the year 1910 and is classified into the following four parts: - Development of a science for every element of work done by staff, scientific selection and training of staff, co-operation with staff and an almost equal division of work and authority between the management and the staff. This theory was invented as a replacement of the previous type of management system where success was accrued to the hard work and co-operation of the staff members of a firm. Scientific Management theory improves the old theory by adding new duties and responsibilities for the managers to the hard work and commitment of staff members

therefore making the management system more efficient than with the previous theory in place (Taylor, 1910).

The theory further stipulates that managers have a responsibility of planning work for the employees and then giving them a set of instructions on what needs to be done, the way it should be done and the time expected for completion. Also, the theory emphasizes those employees who perform well at their jobs deserve to receive a raise in their income. When this theory is applied in management, it helps to reduce wastage of resources as well as improve distribution of services to the customers. When this happens, efficiency can be enhanced thereby leading to improve performance of institutions. This theory is critical to our study by informing the current study that scientific approach to management play a key role in saving costs in the organization and therefore achieving operational efficiencies that in the return result in better financial performance.

### 2.2.2 Efficiency Structure Theory

Efficient Structure theory states that there is a positive relationship between firm's performance and its efficiency. It operates on the premise that "the most efficient firms accumulate a larger market share" (Mensi and Zouari, 2011). The theory emphasizes that when banks incorporate better management practices and scale of operations, higher profits can be realized over time leading to increase in market share. The increase in market share by firms thereafter leads to a higher market concentration, which follows that, the shareholder's return as well as the profit is as a reflection of management's commitment to a firm.

This theory comprises of two hypotheses which are X-efficiency and scale efficiency hypotheses. According to the X-hypothesis, banks that engage in good management practices tend to increase their profitability and have lower costs thereby move towards a lower-bound cost curve (Miller and Jeon, 2005). On the other hand, scale efficiency hypothesis suggests

that those banks with better scale of operations tend to have reduced costs, which in turn increases the growth and profitability for these banks. Therefore, this theory informs us that firms strive to maintain a low cost structure and make better decisions and policies so as to reach the ultimate goal of high performance.

**2.2.3 Market - Power Theory**

Market power theory states that a rise in forces within the external market will lead to profit (Ongore and Kusa 2013). It argues that banks can influence market prices, which in turn leading to increase in profits over time. MP theory comprises of relative- market power and structure-conduct performance hypotheses. Relative market power theory suggests that those banks with brand identity are capable of influence market prices as well as increase their profitability. Therefore, well-known banks are likely to higher profits as compared to those with little brand identity.

On the other hand, structure conduct performance theory states that there is an inverse relationship between market concentration and competition due to the fact that this concentration promotes collusion of firms (Edwards, Allen and Shaik, 2005). The theory emphasizes that when markets are highly concentrated; competition for customers reduces pulling loan rates up and pushes deposit rates down (Miller and Jeon, 2005). SCP argues that when there the market is more concentrated, the cost of collusion of firms lowers allowing firms to make supernormal profits (Mensi and Zouari, 2011). Therefore, this theory informs our study that firms that operate in a very concentrated market are likely to earn more profits than those firms that operate in a lowly concentrated market.

## 2.3 Empirical Literature Review

This section gives an account of past studies done by researchers in respect to the concept of management quality and its relationship with financial performance.

### 2.3.1 Staff Training costsand Financial Performance

Training is the act of imparting knowledge or information to an individual to better his/her performance. Training helps to improve knowledge, talent and skills of workers which are necessary for them to gain a competitive edge and perform duties effectively (Sila, 2014). Institutions spend their finances on training and development as an investment in employees so as to gain a higher return (Abeguki, Paul, Akinrole and Ugochukwu, 2014). Untrained staff could make mistakes in delivery of services and thus diminish productivity of an institution. It is the responsibility of managers to ensure that the employees are well informed on their roles and the importance of their role in achieving goals of the institution.

Various methods are used to train employees of an organization. They include on the job training, off-the job training, classroom training, coaching and job rotation (Abeguki et al, 2014). Banks commonly use job rotation method whereby trainees are assigned tasks, say, in a particular department for a period of time after which they are then moved to another department when the period lapses. A study conducted by Wambugu and Ngugi (2012) on factors influencing sustainability of microfinance institutions in Kenya using a case of KWFT revealed that financing training for staff competencies positively influences performance at KWFT thus enhancing its sustainability. They also note that employees should develop their skills and competencies so that they can grow with the organization (Wambugu and Ngugi, 2012).

A study on the effects of micro-credit, micro-savings and training on the growth of small and medium enterprises in Machakos County in Kenya (2014) found that micro-credit, micro-savings and training jointly contribute positively to SMEs growth. Many studies had been done in Kenya on SMEs and how they are influenced by microfinance services no study had focused on the effects of microfinance services on the growth of SMEs in Machakos County. Therefore, this study focused on the effects of microfinance services and training on the growth of SMEs in Machakos County. It resolved to answer the following question: how do microfinance services and training influence the growth of SMEs in Machakos County?

### 2.3.2 Operational Efficiencycosts and Financial Performance

Efficiency is the ability to ensure that there is little or no waste of resources while doing a task. Operational efficiency is defined as "the tactical planning of an organization to keep a healthy balance between cost and productivity" (Jindal, 2014 p.69). The quality of management can be measured by assessing managers' ability to meet the goals of a bank without wasting resources (Ongore and Kusa, 2013). Jindal (2014) notes that it is those banks which are efficient that can survive competition due to their low costs of operation.

A bank's efficiency can be linked to the growth of an economy. This is because banks face less risk such as reputational risk thus are said to have less chance of failure and in turn have high performance (Jindal, 2014). Also, it is assumed that when a bank incurs more expenditure, it is likely to earn less profits and also when it incurs less expenditure, it would then gain more profits. However, this is not always the case, because an institution incurring a lot of expenditure could be as a result of having more banking activities thereby translating to an increase in revenues which leads to increased profitability (Olweny and Shipho, 2011). According to them, a bank is likely to pass its costs to the customers therefore retaining more profits, say, in the case where banks have brand identity.

A study was done to determine the factors influencing product adoption by MFIs in Kenya(Mbogo and Ashika, 2011). The study elaborated adequate factors behind the innovation adoption but did not correlate it to any other variables. The research covered a single period of study, implying that the factors may have changed over time. Furthermore, the data showed that legal environment, liquidity, competitive pressure and risk management challenges had the greatest influence on innovation of microfinance institutions.

Due to the highly dynamic and competitive environment, firms find it necessary to become competitive through innovation. Matayo (2016) did a study on the effect of financing innovations on the growth of microfinance banks in Kenya. The study found out that microfinance banks were increasingly innovative in the past five years as witnessed by new products, new technologies, improved marketing and improvements in existing products among other factors. It was noted that firms that had financed innovation adequately tend to have competitive edge over the others. It was further noted that these innovations have resulted in accelerated growth of microfinance banks in Kenya and a larger share of the revenues for these MFBS came from the newly introduced products, that is, those that they did not produce five years ago.

### 2.3.3 Strategic Planning costsand Financial Performance

Those who study performance of small business utilize one of two perspectives: survival and success. Obviously a venture fails when it ceases to exist as an economic entity thus survival is an absolute measure of venture performance that depends on the ability of the enterprise to continue to operate as a self-sustaining economic entity (Barney, 1986.). Success, by contrast, is a relative measure of business performance, which manifests itself in the ability of the venture to create value in an economically efficient manner (Coyne, 1986).Past research done by Sotunde Antony of University of Agriculture, Nigeria, dated May 2012 showed that

organizations with no vision and mission statements performed significantly worse than those with vision and mission statements, and leaders who may hold their vision and mission statements implicitly (subconsciously) making it hard to communicate to others reduce their effectiveness.

A plan is a framework with which an activity would be carried out. Strategic planning is the process of developing that framework and deciding on what resources are needed to pursue the strategy. Strategic planning is defined as the "ongoing practice of organizations and firms to improve firm's performance by designing and producing the techniques or strategies to generate results" (Hunjra, Shamim and Ali, 2014). According to Sadikoglu and Olcay (2014), opinions of employees should be considered while coming up with the strategy, vision, mission, objectives of an organization as this draws their support and acceptance of the organization's plans.

Coming up with a strategy involves financing of activities that involves determining the goals and objectives of an enterprise and the adopting a course of action and then allocating necessary resources that should help meet those goals. Sadikoglu and Olcay (2014) carried out a research on the effect of financing total quality management practices on performance and found out that strategic planning is positively related to performance of employees as well as social responsibility. The researchers noted that employees are highly motivated when their input is considered due to a sense of belonging felt by them. Failure of many enterprises in recent time has been attributed to a poor plan.

Also, Hunjra et al (2014) did a study on the impact of strategic planning financing on financial performance of small and medium banks in Pakistan and found out that there was a positive and relationship between strategic planning financing and financial performance.Strategy provides stability and consistency. A good strategy when adequately

implemented can ensure a topmost position for the weakest firm among other superior firms. They also noted that there was a significant relationship between both ROA and ROE; and strategic planning.

## 2.4 Conceptual Framework

The study conceptualizes that management quality through staff training, operational efficiency and strategic planning influences financial performance of microfinance banks. The relationship is shown in the figure below:

**Independent Variables**                                        **Dependent Variable**

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┌──────────────────────────────┐
│ Staff training costs          │
│   • On- job training costs    │
│   • Job rotation costs        │
│   • Costs of hiring trainers  │
│   • Stationery and equipment  │
└──────────────────────────────┘
                                          ┌──────────────────────────────┐
┌──────────────────────────────┐          │ Financial performance of      │
│ Operational efficiency costs  │          │ microfinance banks            │
│   •  Research and             │   ───▶   │                               │
│      development costs         │          │   •  Profitability –ROE       │
└──────────────────────────────┘          └──────────────────────────────┘

┌──────────────────────────────┐
│ Strategic planning costs      │
│   •  Budgeting costs          │
│   •  Hiring strategic         │
│      managers                 │
└──────────────────────────────┘
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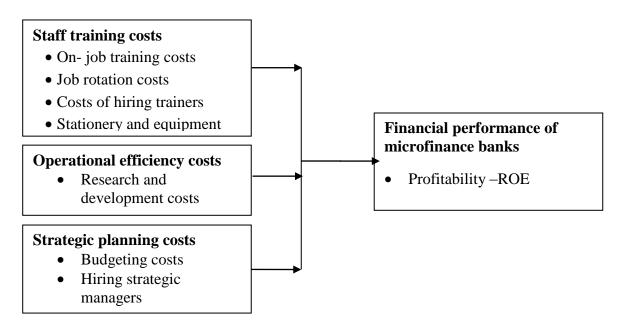
**Figure2.1: Conceptual framework**

## 2.4.1 Operationalization of Variables

This section presents the measurements that will be used to operationalize the variables of study.

**Table2.1: Operationalization of variables**

| Variable | Measurement |
|---|---|
| Staff training costs | Expenses per Employee |
| Operational Efficiency costs | Cost of innovation |
| Strategic Planning costs | Income per employee. |
| ROE | Net Income after Taxes divided by Shareholders' Equity |

## 2.5 Research Gap

There is very little research that has been carried out on management efficiency in microfinance banks wherein most literature is derived from European countries. Locally, most studies have been done on quality of management but revolve around the commercial banks only. The existing body of knowledge is not sufficient thus this paves way for the study to determine the effect of the level of management quality on the financial performance of microfinance banks in Kenya.

## 2.6 Research Hypotheses'

The following hypotheses will be used to test the regression model variables: -

**H0$_1$**: Staff training costs have no significant influence on financial performance of microfinance banks in Kenya.

**H0$_2$**: Operational efficiency costshave nosignificantinfluence on financial performance of microfinance banks in Kenya.

**H0$_3$**: Strategic planning costs have no significantinfluence on financial performance of microfinance banks in Kenya.

# CHAPTER THREE

# RESEARCH METHODOLOGY

## 3.1 Introduction

This chapter describes how the research was conducted so that the readers comprehend the conditions involved in the study. It will present the research design, population of study, sampling design and procedure, instrumentation and data collection procedure, validity and reliability and data analysis and presentation.

## 3.2 Research Design

Research design is a framework used to answer research questions in a study. It is described as the glue that sticks all the variables of a research process (Maina, 2013). Descriptive research design will be adopted for the study. Descriptive studies are essential in describing situations that utilize qualitative data (Maina, 2013). The design would help the study to determine the effect of quality of management on financial performance of microfinance banks in Kenya with specific reference to KWFT.

## 3.3 Population of Study

A population is a number of individuals taken from a large group who share common characteristics. Mugenda (2008) defines a population as a group of objects, individuals or even events that have similar features that can be observed. The population of the study is all the licensed microfinance banks operating within the Nairobi Central Business District in Kenya. As at June 2015 there were a total of 12 licensed microfinance banks in Kenya (CBK, June 2015). However, a survey carried out by ICPAK2015 indicated that only 6 of the microfinance institution keep well audited financial statement.

## 3.4 Instrumentation and Data Collection Procedure

Primary data wasused in the study. The data collection tool used was a data collection form. The instrument was considered appropriate because of its convenience, as it allows fordata extraction to be undertaken almost anywhere and is easy to create and implement. The data collection form had staff costs, innovation costs, planning costs and return on equity.

## 3.5 Data Analysis and Data Presentation

Quantitative data collected was coded and quantitative data analyzed through descriptive and inferential statistics. Statistical Package for Social Sciences (SPSS) package was used to give statistics such as the mean, standard deviation and variance.

The relationshipbetweenthe dependent variable andtheindependent variables were determined by regressionmodel.Variablesdatawas analyzed usingStatistical PackageforSocial Sciences (SPSS). A multiple regression model was used to determine the effects of the capital structure on the financial performance of dairy SMEs and the relative effects of equity financing and debt financing on financial performance.

The detail analysis was carried out with the help of above indicators. Comparisons were all supported by measuring the "p-value", that is to say, the probability level that ensured the significance of the results and establish that the comparisons are statistically valid (the limit of significance was set at 0.05 or 5%). Significanceoftotal quality management variablesaspredictorsof financial performancewas tested usingthet-test. Thesignificanceoftheoverallmodelinexplainingperformancethroughtheindependentvariablesw asmeasuredthroughthef-test.Theanalyzeddata was then presented using tables.Below is the regression model was used in the data analysis.

$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \varepsilon$.

Where;

Y= Financial performance of MFB,

$\alpha$ = constant representing performance of MFB

$X_1$= staff costs,

$X_2$= innovation costs,

$X_3$= Planning cost,

$\varepsilon$= error term.

# CHAPTER FOUR

## FINDINGS AND DISCUSSION

### 4.1 Introduction

This chapter presents the analysis of data, findings from the study and discussion of the findings. Section 4.2 presents descriptive analysis;section 4.3 correlation analysis; Section 4.4 presents multiple regression analysis whereas section 4.5 discussions of findings.

### 4.2 Descriptive Analysis

The study sought to collect and analyze consolidated data from 6 microfinance banks. Secondary data obtained from audited reports published by the organization Newsletters. The dependent variable, return on investment was used as a proxy to measure financial performance of microfinance banks.

### 4.2.1 Response Rate

The study realized a response rate of 100% from the microfinance banks surveyed to utilize their financial statement. The results were only on usage financial statement of these institutions. This was realized as a result of thorough desktop analysis of audited and published financial statements of these microfinance institutions.

**Table 4.1: Response rate**

| Response | Frequency | Percent (%) |
| --- | --- | --- |
| Responded | 6 | 100 |
| Not responded | 0 | - |
| **Total** | **6** | **100** |

### 4.2.2 Mean of Ratios

The study aimed at establishing the mean of the ratios in the study. The study revealed that the mean ratio of staffing cost to be 618803.8056, which of cost of innovation, to be 483744.1944, cost of planning to be61762.0556whereas that of return on equity was 10.0633. The results are as shown in the table below.

**Table 4.2: Mean of Ratios Descriptive Statistics**

|                    | N | Mean        | Std. Deviation |
|--------------------|---|-------------|----------------|
| staffing cost      | 6 | 618803.8056 | 9.37412E5      |
| cost of innovation | 6 | 483744.1944 | 4.78968E5      |
| cost of planning   | 6 | 61762.0556  | 1.08022E5      |
| ROE                | 6 | 10.0633     | 3.02728        |

### 4.3 Correlation Analysis

A partial correlation analysis using Karl Pearson correlation coefficient was performed. A positive coefficient indicated a negative relationship between the variables correlated; in which case an increase in one variable would result into a decrease in the other variable and vice versa. A negative coefficient on the other hand indicates a positive relationship in the variables; meaning that changes in the variables move together. An increase in one variable would therefore result into an increase in the other variable and vice versa.

The measures were constructed using summated scales from both the independent and dependent variables. As cited in Cooper and Schindler (2000) the correlation coefficient value *(r)* range from 0.10 to 0.29 is considered weak, from 0.30 to 0.49 is considered medium and from 0.50 to 1.0 is considered strong. However, according to Field (2005), correlation coefficient should not go beyond 0.8, to avoid multi-collinearity. Since the highest correlation coefficient is 0.674 which is less than 0.8, there is no multi-collinearity problem in this research. Table 4.1 shows the correlation analysis.

**Table 4.2: Correlation Analysis**

| | Staffing cost | Cost of innovation | Cost of planning | ROE |
|---|---|---|---|---|
| Staffing cost | 1 | | | |
| Cost of innovation | .674 .001 | 1 | | |
| Cost of planning | -.044 .001 | -.070 .001 | 1 | |
| ROE | .324 .001 | .420 .001 | .424 .001 | 1 |

Results in table 4.2, on Pearson correlation coefficient revealed that Staffing cost has significant positive relationship with Cost of innovation (r = 674, p< 0.05),negative weak relationship with Cost of planning(r = -.044, p < 0.05)and a positive relationship with ROE (r = .324, p< 0.05) respectively. Cost of innovationhas a negative relationship withCost of planning(r = -.070, p< 0.05). Cost of innovation has a positive relationship with ROE (r = 0.420, p< 0.05). Finally, the cost of planning has a positive relationship with ROE (r = 0.424, p< 0.05).

## 4.4 Regression

A regression analysis between the dependent variable and the independent variables was carried out where staffing costs, cost of innovation and cost of planning were the independent variables while the dependent variable was return on equity. Table 4.3 indicate that the r-squared for the model was 0.568, which indicates that the independent variables can be used to explain about 56.8% of the variation infinancial performance of microfinance banks in Kenya. The results are as shown in the table below.

**Table 4.3: Model Summary**

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate |
|---|---|---|---|---|
| dimension0  1 | .754[a] | .568 | -.079 | 3.14498 |

a. Predictors: (Constant), cost of planning, staffing cost, cost of innovation

Results in table 4.3 give the analysis of variances in the regression model. These results indicate that the model had an f-ratio of .878 which was significant at 0.5% level of significance. This result indicates that the overall regression model is statistically significant and is useful for prediction purposes at 5% significance level. This further indicates that the independent variables (staffing costs, innovation costs and cost of planning) used are statistically significant in predicting financial performance of microfinance banksin Kenya.

**Table 4.4: ANOVA**

| Model | | Sum of Squares | df | Mean Square | F | Sig. |
|---|---|---|---|---|---|---|
| 1 | Regression | 26.040 | 3 | 8.680 | .878 | .005[a] |
| | Residual | 19.782 | 2 | 9.891 | | |
| | Total | 45.822 | 5 | | | |

a. Predictors: (Constant), cost of planning, staffing cost, cost of innovation
b. Dependent Variable: ROE

Results in table 4.5 below present the test of the statistical significance of the independent variables in the model. This provides the estimates of independent variables, their standard error and the t-ratios. The table also provides the statistical significance of each independent variable in the regression model. The results indicate that staff training had a t-ratio value of0.926. This t-ratio is significant at5% level of significance (.926) which indicates that staff training is a significant predictor of financial performance of microfinance banks in Kenya. The estimate of coefficient value for staffing cost is 0.6208 which indicates that financial performance of microfinance banksis positively influenced by staff training.

The results indicate that the t-ratio for innovation/ operation efficiency of a firm was 1.120. This t-ratio is significant at 5% level of significance (.0379) which indicates that operational efficiency is a significant predictor of financial performance of microfinance banks in Kenya. The estimate coefficient value for innovation costwas 0.1472which indicates that financial performance of microfinance banks is positively influenced operational efficiency.

The results indicate that the t-ratio for cost of planning was 1.071. This t-ratio is significant at 5% level of significance (.0396) which indicates that strategic planning is a significant predictor of financial performance of microfinance banks. The estimate coefficient value for strategic planning is 0.01406 which indicates that financial performance of microfinance banks is positively influenced by strategic planning.

**Table 4.5: Regression Analysis**

| Model | | Unstandardized Coefficients | | Standardized Coefficients | t | Sig. |
|---|---|---|---|---|---|---|
| | | B | Std. Error | Beta | | |
| 1 | (Constant) | 5.918 | 3.006 | | 1.969 | .0188 |
| | staffing cost | .06208 | .000 | -1.922 | .926 | .0452 |
| | cost of innovation | .1472 | .000 | 2.328 | 1.120 | .0379 |
| | cost of planning | .01406 | .000 | .502 | 1.071 | .0396 |

a. Dependent Variable: ROE

**4.5 Hypothesis Testing**

For the purpose of this study it was necessary to carry out hypothesis testing on our study variables to establish clearly the existence or the non-existence of influence of the study variables on the performance of microfinance institutions.

### 4.5.1 H0$_1$- Staff training costs have no significant influence on financial performance of microfinance banks in Kenya

The results of regression analysis indicated that staff training costs were significant at 5% confidence level (.0452). Therefore, hypothesis was rejected.

### H0$_2$- Operational efficiency costs have no significant influenceon financial performance of microfinance banks in Kenya

The results of regression analysis indicated that operational efficiency costs were significant at 5% confidence level (.0379). Therefore, hypothesis was rejected.

### H0$_3$- Strategic planning costshave no significant influence on financial performance of microfinance banks in Kenya

The results of regression analysis indicated that strategic planning costswere significant at 5% confidence level .0396). Therefore, hypothesis was rejected.

### 4.6 Discussion of the Findings

The chapter carried out inferential analysis to establish the effect of quality management on financial performance of microfinance banks in Kenya. Study results indicated that the independent variables of quality management (staff training, operational efficiency and strategic planning) explain and can predict financial performance of microfinance banks in Kenya. These variables could explain about 56.8% of that financial performance of microfinance banks in Kenya.

Similar studies by Ongore and Obonyo (2011) carried out a study to examine the interrelations among ownership, board and manager characteristics and firm performance in a

sample of 54 firms listed at the Nairobi Securities Exchange using a PPMC, Logistic Regression and Stepwise Regression. The results of this study showed a positive relationship between managerial discretion and performance. Williamson's managerial discretion theory posits that managers are interested in maximizing their utility other than maximizing a firm's profits. Therefore, managers may prefer to incur more expenditure and increase staff in order to maximize such utility other than increasing profits of a firm.

# CHAPTER FIVE

## SUMMARY, CONCLUSION AND RECOMMENDATIONS

### 5.1 Introduction

This chapter represents the summary, recommendations, and conclusions of the previous four chapters more especially chapter two that conducted an in-depth analysis on the literature review of the chosen research topic. The recommendation that will be highlighted herein would include areas of further research. Recommendations involve the researcher's opinion and the opinion of other researchers regarding the chosen research topic. The summary provides an overview of the research finding. The conclusions involve the researcher's thoughts or opinions about the study. Therefore, conclusions are made to partly complete the expectations of the objectives of the study that were highlighted in chapter two.

### 5.2 Summary of Findings

The study had a response of 100% from microfinance institutions targeted to source data for the study. The study's adopted model could predict 56.8% of financial performance as a result of the quality management factors. The results of correlation analysis had shown no multi-collinearity among study variables therefore proofing their independence. The regression analysis of the study had shown that staff training had a t-ratio value of 0.926. This t-ratio is significant at 5% level of significance (.926) which indicates that staff training is a significant predictor of financial performance of microfinance banks in Kenya. The estimate of coefficient value for staffing cost is 0.6208 which indicates that financial performance of microfinance banks is positively influenced by staff training costs.

The results indicate that the t-ratio for innovation/ operation efficiency of a firm was 1.120. This t-ratio is significant at 5% level of significance (0.0379) which indicates that operational efficiency is a significant predictor of financial performance of Microfinance banks in Kenya. The estimate coefficient value for innovation costwas 0.1472which indicates that financial performance of microfinance banks is positively influenced by operational efficiency costs.

The results indicate that the t-ratio for cost of planning was 1.071. This t-ratio is significant at 5% level of significance (.0396) which indicates that strategic planning costs are a significant predictor of financial performance of microfinance banks. The estimate coefficient value for strategic planning is.01406 which indicates that financial performance of microfinance banks is positively influenced by strategic planning costs.

## 5.3 Conclusions of the Study

This section of the research project provides recommendations based on the findings of the study as well as link these recommendations to the objectives of the study that were outlined in chapter one of this dissertation. The recommendations are focused mainly on how the five microfinance banks can increase their financial performance using quality management practices.

The study established that staff training costs are a significant factor that influences the financial performance of microfinance banks. Continuous staff trainingencourages employee commitment which in turn reduces turnover costs as well as maintenance costs by reducing equipment breakdowns and further decreases the level of wastage making the microfinance banks to incur less expenses translating to improved financial performance.

Moreover, the study established that strategic planning and operational efficiency costs had significant effect on the financial performance of microfinance banks in Kenya; this implies

that the two add on financial significance. Therefore, it is advised that the management team of microfinance banks in Kenya should be careful when making decisions regarding strategic planning and operational efficiency by coming up with good strategic financial plans and ensuring creativity and innovation in organization for better performance.

## 5.4 Limitations of the Research

Amengor (2010) contend that; the variability and the reliability of any academic paper in one-way or another enhanced only when the researcher acknowledges the limitations of the study, in this study the researcher faced the challenge of having only few microfinance institutions that publish their financial statements or follow clear international financial reporting standards. Therefore, the researcher had to use data from only six microfinance institutions despite there being 12 microfinance institutions in Kenya.

## 5.5 Areas of Further Study

The study was conducted based on a number of limitations that exist in the environment, and the individual characteristics that are in inherent in the mind of the researcher. Therefore, based on these limitations, it is important to make various suggestions to other researcher who would be willing to carry out similar studies on the same research topic.

This study only concentrated on Kenya yet management quality is a key factor in microfinance banks worldwide. The study thus suggests conducting similar studies in other geographical regions more particularly in other countries in order to test the reliability and validity of the findings of this study (Goddard et al., 2008).

Secondly, the study only made use of threequality management variables (strategic planning, costs, staff training costs and operational efficiency costs). Therefore, the study suggests to

future researchers who might be interested in this area to include variables such as risk management, educational background and experience of directors and adequacy of internal controls among others. Various studies should be conducted to determine whether intervening factors that were not considered in this study affect the financial performance of microfinance banks and the extent to which each factor influences the financial performance of MFBs.

Furthermore, the study made use of return on asset to assess financial performance. The study therefore suggests that further studies in this area should make use of other measures of financial performance such as net interest margin and return on equity among others.

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## APPENDICES

**Appendix I: List of Microfinance Institutions in Kenya as at June, 2015**

1. Faulu Microfinance Bank Ltd

2. Kenya Women Microfinance Bank Ltd

3. SMEP Microfinance Bank Ltd

4. Remu Microfinance Bank Ltd

5. Rafiki Microfinance Bank Ltd

6. Uwezo Microfinance Bank Ltd

7. Century Microfinance Bank Ltd

8. Sumac Microfinance Bank Ltd

9. U&I Microfinance Bank Ltd

10. Daraja Microfinance Bank Ltd

11. Caritas Microfinance Bank Ltd

12. Choice Microfinance Bank Limited

(Source: CBK website)

**Appendix II:Data Collection Form**

| Item/year | 2013 | 2014 | 2015 |
|---|---|---|---|
| Staffing Training costs | | | |
| Innovation costs/ research and development cost | | | |
| Strategic planning costs/directors fee | | | |
| ROE=Profit after tax/ shareholders' equity | | | |