PRUDENTIAL REGULATIONS AND FINANCIAL PERFORMANCE OF MICROFINANCE BANKS IN KENYA

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MAY, 2025

DECLARATION

Declaration by the Student

I affirm that this project is entirely my own creation and has not been presented for the purpose of obtaining an award at any other academic institution.

Signature ________________________ Date ________________________

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Declaration by the Supervisor

I verify that this research work was accomplished by the student under my supervision as the chosen University supervisor.

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DEDICATION

I dedicate this study to my mum Mrs. Reginalda Nafula and My Dad Mr. Frederick Wanjala for their spiritual, moral, financial, mental and emotional support.

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ABBREVIATIONS AND ACRONYMS

BRB	Bank of the Republic of Burundi
CBK	Central Bank of Kenya
FSD	Financial Sector Deepening
GDP	Gross Domestic Product
GMM	Generalized Method of Moments
KWFT	Kenya Women Finance Trust
LAR	Loan-to-total-asset ratio
MFB	Microfinance Bank
MFI	Microfinance Institution
MSE	Micro and Small Enterprise
SPSS	Statistical Package for Social Sciences
NBR	National Bank of Rwanda
NIM	Nets Interests' Margins
NSE	Nairobi Securities Exchange
ROA	Returns on Assets
ROE	Returns on Equity
ROI	Returns on Investments
SACCOs	Savings and Credit Co-operatives
SMEP	Small and Medium Enterprises Program
SSA	Sub-Saharan Africa

OPERATIONAL DEFINITION OF TERMS

Capital Regulation: Set of rules and requirements imposed by regulatory authorities on microfinance banks regarding the amount and quality of capital they must maintain to ensure financial stability and mitigate risks. This was assessed by core capital to total deposits.

Credit Regulation: Rules, policies, and guidelines set by regulatory authorities to govern the lending activities of microfinance institutions. This was assessed with non-performing loans to total loans.

Financial Performance: Financial performance is a financial determination of how an organization is doing in terms of its set goals, strategies and everything happen with them. Return on asset was used to assess financial performances in this study.

Liquidity Regulation: The regulatory measures and guidelines imposed by authorities to ensure that microfinance institutions maintain adequate levels of liquidity to fulfill their immediate financial responsibilities. Liquid asset to total asset was used.

Microfinance Bank: Microfinance Bank is an institution that aims at developing people who are deprived of the benefits of the rich society, who are usually overlooked by commercial banks and other establishments giving out loans, and encouraging them to take part in other self-employment options as they provide financial services such as credit, investments, and protection against financial risk for them.

Prudential Regulation: A regulatory framework aimed at ensuring the monetary security and protection of businesses and the financial sector as a whole. This was measured by capital, credit and liquidity regulations.

ABSTRACT

Microfinance enhances the financial capacity of the economically disadvantaged, often ignored by commercial banks and other lending institutions, by offering services such as credits, insurances, and savings, thereby encouraging self-employment. Due to various variables businesses encounter, guidelines, decrees, and rules are necessary to regulate their operations, ensuring a fair structure for all institutions within a sector. This regulatory framework is essential for the financial industry, especially microfinance banks, to operate within set boundaries. This study general objective was to determine the impact of prudential regulations on the financial performance of microfinance banks in Kenya. The study specific objectives were to determine the effects of capital regulation, credit regulation, and liquidity regulation on their financial performance. Theoretical frameworks reviewed include stakeholder theory, capital buffer theory, and liquidity shiftability theory. The study's target population consisted of the fourteen (14) licensed microfinance banks in Kenya, employing a census of all these microfinance banks and an explanatory research design. The investigation utilized secondary data, which was sourced from the financial statements of selected microfinance banks in Kenya. This information encompassed data collected over a seven-year period, from 2015 to 2022. The data analysis involved multiple regression and descriptive analysis. Normality, multicollinearity, stationary, autocorrelation, heteroscedasticity, and diagnostic tests were performed on the data. To ensure ethical considerations, encryption key mechanisms safeguarded all local files, with access restricted to the researcher and supervisors. Findings revealed that capital regulation significantly ($\rho = 0.013$) and negatively ($\beta = -3.3184$) impacts financial performance; credit regulation has an insignificant ($\rho = 0.961$) and adverse ($\beta = -0.0003$) effect, while liquidity regulation significantly ($\rho = 0.008$) and inversely ($\beta = -0.2173$) affects financial performance. The study recommends that microfinance banks recognize the importance of capital management and ensure regulatory compliance. By implementing robust risk management practices, including regular capital level monitoring, stress testing, and strategic capital planning, these institutions can enhance their financial performance, attract investors, and maintain stakeholder confidence.

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

The growth of microfinance institutions globally has heightened the demand for enhanced prudential regulations (Mustafa, 2020). Ngugi and Waithaka (2020) found that microfinance banks predominantly supply capital to low- and middle-income people, hence contributing to national prosperity. These prudential laws will provide sufficient funding akin to that of commercial banks, therefore influencing their performance (Kabochi, 2020). Microfinance institutions must be adequately supported, as strong performance facilitates capital sufficiency and internally generated money, rather than reliance on external funding (Ndegwa, 2018).

Many countries throughout the world have enacted microfinance rules and regulations in order to protect depositors (Cull, Demirg-Kunt, & Morduch, 2019). Diverse countries, however, have chosen diverse regulatory structures for microfinance banks. Microfinance banks can be governed under current banking laws, by a separate statute, or by self-regulation (Haq, Hoque, & Pathan, 2018). Financial performance has grown to be a top priority for policymakers ever since the global monetary crisis of 2007–2009. The US housing bubble that broke in 2007-2008 was the catalyst for the 2007–2009 Financial Crisis. Following the fall of the investment company Lehman Brothers, there were problems with liquidity and solvency, which led to a later global recession. Developed countries were significantly impacted by the basic banking financial crises in the U.S. and Europe. The G10 governors were driven to create a method that would ensure financial success internationally by the periodic financial crises, which resulted in the development of the Camel Model in Switzerland in 1974. A constant characteristic in these agreements is the emphasis on supporting the vital internal finance system components. By establishing minimal requirements for the essential internal elements that banks must achieve, they are all meant to enhance the sector's financial performance (Wafula, 2020).

In numerous emerging economies, notably in Sub-Saharan Africa (SSA), microfinance has been seen as a progressive instrument to combat poverty by offering long-term help to the underprivileged. On the basis of its organizational framework, purpose, as well as approach/methodology, it provides financial support for customers and interested parties who have no access to traditional institutions or other official finance services companies. Like their counterparts in other countries, microfinance banks in SSA offer low-income customers loans, money transfers, savings, insurance, and other financial services. Microfinance institutions are growing more quickly in SSA, putting them to rank among the most productive institutions worldwide in terms of the volume of deposits and borrowers. Additionally, in SSA, microfinance institutions are now employed as development instruments to assist individuals in escaping poverty (Remer & Kattilakoski, 2021).

In Sub-Saharan Africa, Kenya boasts a thriving industry. It offers services for the underprivileged through a vast branch network and a range of institutional structures (FSD Kenya, 2017). The legal, regulatory, and oversight system for Kenya's microfinance industry is established by the microfinance act of 2006 and the microfinance rules of 2008 (AMI, 2017). A number of connected barriers to Kenya's development of a banking and financial industry has shown the need for microfinance' banks. The framework of Kenya's banking and finance industry, the lack of sufficient guideline and control essential for excellence advancements in banking and finance, and profit-driven finanlcial institutions' conservative commercial business practices have all been major roadblocks (Alastair, 2018). A healthy and stable microfinance sector was intended to be promoted via the execution of the Act and the Regulations. Additionally, 24 microfinance organizations in Kenya with over 1.5 million active borrowers saw noteworthy development in 2010. 54 members in Kenya offer microfinance services, according to AMFI.

Kenyan microfinance banks have experienced numerous transformations and reforms in recent years (Rono, 2020). The lack of effective regulation and governance, since regulatory authorities prioritize profit-generating financial institutions, constitutes a significant barrier to the growth of Kenyan microfinance organizations (Alastair, 2015). Microfinance acts were enacted in 2006, followed by the implementation of microfinance laws in 2008 to provide regulatory requirements for microfinance banks (Association of Microfinance Institutions, 2018). However, these prudential laws can either enhance or detract from its financial performance.

1.1.1 Financial Performance

Financial performances refer to financial determination of organizations in terms of its set goals, strategies and everything happen with them. It can be considered as a firm's monetary health that can be comparable to other firms in the same industry (Agola, 2017). A firm's financial performance' is a germane aspect, and it may be assessed by looking at its competitiveness, organizational possibility, the company's financial well-being, and the regularity of current and upcoming contracts. 2018 (Dufera). Financial performances in the background of MFIs are known as MFI's capabilities to remain working in the direction of its microfinance goals without the help of contributors (Thapa, 2018).

Financial performance, according to Adabenege and Yahaya (2019), is the procedure by which the monetary outcomes of companies are measured. It serves to assess the overall financial well-being of an organization throughout a certain timeframe. A variety of ways exist for determining financial performance, but there is a slight agreement on which one to use. Hoque et al. (2020)

divide financial performance measurements into two groups: market-based markers like the Tobin's Q ratio and financial management metrics like Returns on Assets (ROA), Returns on Equity (ROE), or Returns on Sales.

Tomuleasa and Cocris (2019) state that the three primary indicators of ROA, Returns on Investments (ROI), and Nets Interests' Margins (NIM) are used in assessing bank' performances. The objective of the measure dictates the preferred metrics that are used to assess financial performance. According to Ross, Westerfield, and Jaffe (2016) and Ceylan, Emre, and Asl (2018), profitability is the most widely used measure of bank success. The two key indicators of profitability of banks are believed to be ROA and ROE. In this study, financial performances evaluation is in light of ROA and ROE.

1.1.2 Prudential Regulations

Prudential regulation refers to the set of guidelines and regulations implemented to ensure the safety and viability of financial institutions. It encompasses measures that govern capital adequacy, risk management, and liquidity requirements among others. The objective is to promote a stable financial system, mitigate systemic risks, and protect consumers by ensuring that financial institutions operate within a framework that minimizes the likelihood of insolvency and financial crises (Mwenga, 2014; Nuriye & Gatauwa, 2024). In Kenya, the primary authority responsible for issuing prudential regulations is the Central Bank of Kenya (CBK). Section 33(4) of the Banking Act gives the CBK the authority to set guidelines that financial institutions are obligated to follow so as to sustain a stable and efficient banking system. The regulations include a range of banking activities, such as licensing, corporate governance, capital sufficiency, and liquidity management (CBK, 2006; 2013; Mwenga, 2014).

The CBK has established specific thresholds for various prudential regulations, which include capital adequacy where financial institutions are obligated to preserve a minimum core capital of Ksh 250 million. Additionally, the total capital must be at least 14.5% of the total risk-weighted assets (Mwenga, 2014; Nuriye & Gatauwa, 2024). Financial institutions must maintain a liquidity ratio of at least 20%. This ratio is essential for guaranteeing that banks can fulfill their immediate commitments without suffering substantial losses (CBK, 2013; Mwenga, 2014). Furthermore, The CBK has established rules that impose a restriction on the maximum exposure a bank may have to any one borrower or a group of related borrowers. This restriction is set at 25% of the bank's core capital. This is to mitigate the risks associated with high credit concentration and ensure diversification of credit risk (CBK, 2013; Business Results Group, 2023).

A Study by Barth, Gerard, and Levine (2018) According to Till Angels Regulate, due to the various variables that businesses experience, guidelines, decrees, and rules are required to regulate everything they do. This will support the spread of what seems to be a fair arrangement for all companies operating in a certain industry. The finance industry, especially banking-microfinance banks, must be under regulation so that they can carry out operation according to the set guidelines.

The sum of cash at hand to sustain the bank's activity, which serve as a cushion when there is crisis is referred to as capital. Deposits are effectively money other people saved that may be returned whenever it is needed by the depositors; therefore, capital provides liquidity for a banking company (Dang, 2016). In the case of asset loss, a greater capital level compared to assets guarantees that the organization has adequate cash on hand to pay the loss or that the capital necessary to sustain prospective risks whilst maintaining financial sustainability is sufficient (Adhikary, 2016). As a result, in the face of asymmetric information, a bank might communicate to the market that improved performance is likely (Kahiga, 2017).

The capability of an establishment to raise cash when it needs it. When a MFB becomes unable to satisfy its financial needs or transaction commitments in a promptly and cost-effective way, liquidity risk emerges (Idama, Asongo & Nyor 2016). MFIs with a lack of liquidity may be more susceptible to upcoming uncertainties, refinancing delays, obstructions to achieving expansion goals, and increased portfolio risk (Brom, 2019).

Every single office of a microfinance bank is required to create a regular funding plan that governs the regular balancing of future cash flows from savings and debt repayment with cash withdrawals for the branch in order to reduce liquidity risk (Idama et al., 2016). One often-used statistic to evaluate the liquidity of an MFI is the loan-to-total-asset ratio (LAR). It indicates the proportion of total asset utilized to issue a loan.

Detection, assessment, supervision, and control of credit risk from the potential of delayed payments in reimbursements are only a few of the things that credit risk regulation comprises. (Coyle, et al., 2017). Banks lend loans on the premise that lenders will pay off their debt, although credit is granted to loan borrows might lead to defaults. Revenue will vary because microfinance institutions don't predict what percentage of their debtors will fail, increasing the risk of profit swings for the banks (Onyiriuba, 2019).

It is impossible to overstate how essential credit risks regulation is in microfinance performance. Credit risks must be properly managed and controlled to increase client trust credit risk regulation employs bank risk, improved risk level of interest, and evaluating the impact of credit risks regulations on banks profitability to limit credits risk exposure to a minimum. (Kargi, 2016).

1.1.3 Microfinance Banks in Kenya

Microfinance bank or deposits taking microfinance business is defined under the Microfinance Act (2006) as a firm where the individual running the business offers himself up as receiving credits every day. These banks are approved by the Microfinance Act (2006) which are not properly regulated institutions. However, because they use the money their customers deposited to get money for independent loans, they will be guarded by the same restrictions under the Central Bank's prudential regulation. Demand deposits are accepted by microfinance banks, and they are used to create capital which is used for the granting credit to consumers (Alastair, 2018).

Kenya was ranked first in Africa and sixth worldwide in terms of microfinance activities (Ayele, 2018). Only roughly 56 of Kenya's nearly 250 microfinance institutions are licensed by Association of Microfinance Institutions, an advocacy group. As of December 2016, Kenya had 13 deposits taking microfinance institutions. Kenya Women Finance Trust (KWFT), Small and Medium Enterprises Program (SMEP), Rafiki MFB, Sumac MFI Bank Ltd, Faulu Kenya, Century MFI, and Uwezo MFB are just a few of the prominent companies in the sector (Njenje & Bengi, 2016).

Kenya's microfinance business caters to households that are receiving little money as their income and Micro and Small Enterprise (MSEs) participating in an economic activity that is not related to farming. MFBs have make known some important advances in goods and services that are used by MSEs over time (Gibson, 2018). The overall resources of the microfinance sector have grown steadily over the last three years, with banks dominating the sector (Agola, 2017).

1.2 Statement of the Problem

Microfinance is a technique for boosting the capacity of those who are left out of the benefits of the wealthy society and typically left out by commercial banks and loaning establishments, encouraging them to engage in other self-employment opportunities as they provide financial services like loans, investments, and insurance for them (Anand & Kanwal, 2016). The purpose of microfinance has been to improve the lives of its consumers or to promote small-scale economic activity for a long time (Addisalem, 2016).

Return on asset is one of the metrics microfinance banks uses in measuring their performance. It shows how microfinance put the assets they have to make profit. Microfinance banks are dedicated to making life of the poor easier by proving loans for them, but when these microfinance banks are not financially performing well, it will prevent them from providing the services they ought to provide for their customers. The profit microfinance banks make help them to provide these services.

The financial success of Kenya's microfinance banks has been appalling despite the importance and improvements in their development (Central Bank of Kenya, 2019). As per the supervisory report from the CBK, the financial losses experienced by 13 microfinance banks surged by an alarming 561% in 2020 compared to the previous year, escalating from Ksh 339 million in 2019 to Ksh 2.2 billion in 2020. In 2015, microfinance banks achieved a return on equity of 5%, marking the only year in the analyzed period where they generated notable profits. However, subsequent years saw a decline in shareholder returns, with negative figures recorded: -3.2% in 2016, -5.5% in 2017, -13.8% in 2018, -3% in 2019, and a staggering -28% in 2020. Furthermore, the Return on Assets (ROA) for microfinance banks was reported at -0.9% in 2017, deteriorating further to -5.5% in 2018. Although there was a slight recovery in 2019 with a ROA of -0.4%, the situation worsened again, with ROA figures of -3.8% in 2020 and -0.96% in 2021 (CBK, 2022). This data underscores the significant challenges faced by microfinance banks in Kenya during this period, particularly in terms of profitability and asset management.

Mersland and Strom (2019) found that knowing how regulations and supervisions affects the performances of microfinance banks is important in their investigation on efficiency and governance in microfinance institutions. This current investigation assessed the effects of capital, credits as well as liquidity regulations on Kenyan microfinance banks unlike the survey by Mersland and strom who investigated the Performance and governance in MFIs.

Ali (2016) investigated Kenya's microfinance regulation and supervision structure. The majority of literature in the domain of monitoring and supervising MFBs indicates that microfinance business should be monitored to provide enormous and long-term financing services to individuals who are receiving little income, according to the study. Unlike the investigation by Ali that looked at Kenya’s microfinance regulation and supervision structure, this currents study examined the impacts of credit, capital and liquidity regulations on finance performances of microfinance in Kenya.

According to research by Njeule (2018), prudential policies of CBK have influences on well-being of Kenyan commercial establishments monetarily when changes are made to capital, liquidity, asset risk organization, and establishment, being subjected to foreign exchange risk, and business management. Thus, CBK's prudential policies are effective and have significantly been promising on commercial bank financial performance. Unlike the investigation by Njeule that looked at CBK’s regulation and impacts it has on financial performances, this currents study examined the effects of prudential regulations on financial performances of MFBs in Kenya.

Influence of liquidity on bank profitability of microfinance banks was researched by Otieno, Nyagol, and Onditi (2016), and findings suggested liquidity favorably influenced profitability of microfinance banks. Majority of the studies looked at commercial banks. However, Otieno, Nyagol, and Onditi concentrated on microfinance banks and only looked at liquidity issues. This study closed the gap by looking at how regulations like capital, credit, and liquidity regulations affects the financial performances of MFBs in Kenya.

1.3 Objective of the Study

1.3.1 General Objective

The general objective of this study is to examine the effect of prudential regulations on financial performance of microfinance banks in Kenya.

1.3.2 Specific Objectives

The specific objectives are:

i. To determine the effect of capital regulation on financial performance of microfinance banks in Kenya.

ii. To examine the effect of credit regulation on financial performance of microfinance banks in Kenya.

iii. To assess the effect of liquidity regulation on financial performance of microfinance banks in Kenya.

1.4 Research Hypotheses

The research hypotheses include the following:

> **H_{o1}**: Capital regulation has no significant effect on financial performance of microfinance banks in Kenya.
>
> **H_{o2}**: Credit regulation has no significant effect on financial performance of microfinance banks in Kenya.
>
> **H_{o3}**: Liquidity regulation has no significant effect on financial performance of microfinance banks in Kenya.

1.5 Significance of the Study

The study holds significant implications for the Government of Kenya and the CBK. By examining the relationship between prudential regulations and financial performance, the findings would inform policymakers on the effectiveness of existing regulations and highlight areas needing improvement. This research would enable the government to create a more robust regulatory framework that supports the stability and growth of MFBs, which play a crucial role in enhancing financial inclusion among underserved populations. Furthermore, insights from the study would guide the CBK in refining its supervisory practices to ensure that microfinance institutions operate within safe and sound parameters, ultimately fostering a more resilient financial sector.

For the management of microfinance banks, investors, and other stakeholders, this study provides valuable insights into the impact of prudential regulations on financial performance. Understanding how capital adequacy, liquidity, and credit regulations influence profitability would help bank managers make informed decisions regarding resource allocation and risk management. Investors would benefit from this research by gaining a clearer picture of the financial health and sustainability of their investments in microfinance institutions. Additionally, stakeholders, including community organizations and development partners, would leverage these findings to advocate for policies that enhance the operational environment for microfinance banks, ensuring they can effectively serve their target markets.

Scholars and academicians would find this study significant as it contributes to the current corpus of knowledge on regulatory frameworks and microfinance. By exploring the dynamics between prudential regulations and financial performance, the research opens avenues for further academic inquiry into the microfinance sector in Kenya and beyond. It encourages a deeper understanding of how regulatory measures can be optimized to improve the financial viability of microfinance institutions. Moreover, the study can serve as a foundational reference for future research, enabling scholars to build on its findings and explore related themes such as financial inclusion, risk management, and economic development in the context of microfinance.

1.6 Scope of the Study

The primary aim of the investigation evaluated prudential's guidelines (capital, credit, and liquidity) effect on the financial performances of Kenyan MFBs. Stakeholder theory, capital buffer theory, and liquidity shiftability theory were all part of the study's theoretical framework. Kenyan microfinance banks were considered. The study covered the time period 2015 to 2022, hence making it the time scope. The selected time frame for this study is particularly significant due to the recent political developments, including the repeal of interest rate caps, the implementation of more targeted policies, and the impacts of COVID-19 during its various phases (pre, during, and post). This shaped the regulatory framework of the central banks in enhancing the operational capacity of the microfinance banks, thus making this contemporary context essential for understanding the current dynamics in the microfinance sector financial landscape. The methodological scope utilized panel regression and descriptive analysis.

1.7 Limitation of the Study

Numerous constraints were encountered during and subsequent to the research. The explanatory research design was implemented for our research methodology. This approach can be time-consuming due to the necessity of collecting data from multiple sources. However, this obstacle was resolved by establishing clear objectives and predicting future outcomes, which facilitated the avoidance of unnecessary time consumption. Furthermore, the findings of the investigation will be applicable to microfinance banks, rather than other banking institutions.

1.8 Organization of the Study

The arrangement of the investigation includes: Chapter one contains introduction, problem statement, objectives, scope, and limitations; Chapter two includes review of the literatures and empirical analysis of the factors related to prudential regulations and monetary performance; and chapter three includes review of the literatures and empirical analysis of variables pertaining to prudential regulations and financial performances and the investigation approach. The fourth chapter of the survey detailed the interpretation, analysis and discussion of findings. The last chapter which is the fifth chapter provided summary, conclusion of the survey with recommendations provided as well.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This Chapter discusses Prudential Regulations and Financial Performances of MFBs in Kenya. The literature review addresses aspects such as capital regulation, credit regulation and liquidity regulation that influence the financial performance of MFBs in Kenya. This section contains a synopsis of the literature review as well as research gaps. The proposed framework was also discussed.

2.2 Theoretical Review

The stakeholder theory, capital buffer, and liquidity shiftability theory was used.

2.2.1 Stakeholder Theory

The stakeholders' theory was postulated by Freeman in 1984. The theory asserts that corporations have a responsibility not just to their shareholders but also to a broader range of stakeholders who have the ability to influence or be influenced by the organization's activities (Freeman, 1984). The stakeholders include many groups including as workers, consumers, suppliers, the community, and regulators. The thesis posits that firms need to provide value for all stakeholders, rather than only focusing on maximizing profits for shareholders. This broad perspective is rooted in the belief that long-term success and sustainability are best achieved when the interests of all stakeholders are considered and balanced.

The theory considers a larger group that influences corporate aims and actions. Internal and external stakeholders are recognized as two sorts of stakeholders in this theory. Internal stakeholders encompass workers, management, and founders, while external stakeholders consist of distributors, the government, lenders, consumers, the broader society, and the external context in which the firm operates. The involvement of various stakeholders in business decisions can contribute to conflict reduction and facilitate the smooth functioning of the company, as highlighted by Turnbull (1994). Stakeholder theory outlines three primary methodologies: normative, instrumental, and descriptive. The descriptive technique serves to demonstrate the qualities of a company's management, whereas the instrumental approach illustrates the link between the managerial group of stakeholders and the organization's goals. The normative approach according to Donaldson and Preston (1995), proposes principles for effective organisational administration and performance.

Bank regulations acknowledge all of the aforementioned stakeholders due to their fundamental contribution to the profitability of the firm. As stated by McDonald and Puxty (1979), Companies do not just prioritize shareholders, acknowledging the need to also consider the wider society in which they operate. In recent years, the concept of social and environmental accounting has gained growing significance within the contemporary corporate landscape. The environment is a crucial stakeholder in the operation of a corporation, claim Starik and Rands (1995). Since it provides information that helps in the fulfillment of societal obligation, information about a company's operating conditions is now becoming more and more essential for both organizations and knowledge consumer. Furthermore, it assists in substantiating the company's response to specific ethical dilemmas that emerge within that particular context. Some businesses that support communal environmental issues have become eco – friendlier in their operations (Gray, Collison and Bebbington 1997).

The stakeholder theory serves a pivotal role in highlighting the accountability of organizations towards all parties impacted by their operations. This includes not only microfinance institutions but also regulatory bodies, clients, investors, employees, and the wider community. By integrating stakeholder theory into the research, the analysis will encompass a thorough examination of the diverse effects that prudential regulations have on the financial performance of microfinance banks. This approach will take into account the interests, viewpoints, and results for different stakeholders, which is essential for grasping the extensive ramifications of regulatory actions within the microfinance industry.

2.2.2 Capital Buffer Theory

According to buffer theory, which was put forth by Calem and Rob in 1996, a bank may be able to raise reserve and lower risk if it exceeds the regulatory capital minimal ratio, so they can prevent the regulatory fines associated with a capital break. The hypothesis is based on the capital adequacy ratio's volatility, and capital's consistency and trustworthiness for planning a long-term goal. Financial institutions encounter difficulties in securing sufficient deposits, there is a potential for erosion of their capital foundation. In such a scenario, the bank's stability is compromised, posing a risk to its capital adequacy ratio.

The amount of capital that is held by a bank over the required minimums is known as the capital buffer. This serves as insurance against long-term financial hardship and bankruptcy as well as protection against fines and possible closure by regulatory agencies, which see failure to meet monetary requirements as a serious breach of banking regulations (Tochukwu, 2016). Guidelines are designed with the goal of creating appropriate capital buffers, according to Kariuki and Wafula (2016). These frameworks consider multiple elements, such as the bank's size, risk characteristics, and the economic context in which it functions. By following these regulations and ensuring they have sufficient capital buffers, banks play a vital role in enhancing the overall stability of the financial system, thereby minimizing the chances of systemic crises that could significantly impact the economy (Basel Committee on Banking Supervision, 2019).

Regulations aim to limit lending's procyclicality by encouraging the construction of countercyclical buffers (Nasikeu, 2016). The capital buffer hypothesis noted that banks having inadequate capital buffers want to restore its capital buffers by getting funding, whereas banks having strong capital buffer try keeping their capital buffer. Increased capital helps to maintain downturn, lowering the chance of loss. When investment risk rises, banks add capital to maintain their capital buffer. Banks with little capital may well be enticed in taking additional risks in the hopes of increasing their capital (Tochukwu, 2016).

Therefore, depending on the institution's risk-taking behavior, the link between capital adequacy along with efficiency may be either positive or negative. The concept might be considered when describing how capital adequacy and financial performance are related. The significance of capital buffer theory in this study stems from its ability to account for differences in financial performance among microfinance banks in Kenya. Banks that uphold larger capital buffers are likely to exhibit enhanced resilience and stability, which can contribute to improved financial results over time (Basel Committee on Banking Supervision, 2019). In contrast, microfinance banks with smaller capital buffers may be more susceptible to economic disturbances, leading to weaker financial performance. This study supports capital regulation's objective

2.2.3 Liquidity Shiftability Theory

Moulton (1918) introduced the shiftability hypothesis of bank liquidity, which posits that banks can enhance their liquidity by holding financial instruments that have a readily accessible secondary market. This strategy allows banks to safeguard against significant credit demands by maintaining a reserve of liquid assets that can be quickly converted into cash. The instruments in question are typically characterized by their early maturity dates and inherent capital security, making them easily tradable. By ensuring that they possess such liquid resources, banks can effectively mitigate their exposure to financial risks associated with sudden withdrawals or credit demands. However, this practice can also negatively impact financial performance, as highlighted by Sheefeni (2016), suggesting that while liquidity reserves are essential for stability, they may come at the cost of reduced profitability.

The shiftability theory of bank liquidity postulates that a bank's liquidity position is upheld in a healthy state when it possesses assets that can be easily transferred to creditors and depositors or readily converted into cash. The theory further suggests that a bank's liquidity may be improved if it constantly hold assets that are readily available for sale, even if they must be sold at a discounted price to the central bank or secondary markets. The underlying premise is that for a bank to sustain adequate liquidity levels, its assets must be highly transferable, marketable, and shiftable (Nguyen, Perera & Skully, 2017). This allows the bank to quickly convert these assets into cash to meet the demands of depositors and creditors, ensuring the bank's ability to maintain its liquidity position and avoid potential liquidity crises (Choi, Gam, Park & Shin, 2020).

According to the risk intake thesis, higher capital ratios are highly correlated with higher liquidity levels, which enhances banks' ability to generate liquidity. This is because risk-bearing capacity influences capital adequacy and liquidity, which in turn affects capital adequacy and liquidity, the theory is helpful in identifying appropriate capital adequacy and liquidity. The theory is applicable to the research since it emphasizes the need of preserving liquid assets that may be readily turned into cash in order to fulfill immediate financial commitments. MFBs, which serve low-income segments and often face liquidity challenges, the theory suggests that the ability to hold marketable and transferable assets would enhance financial stability and performance. By adhering to prudential regulations that promote liquidity management, these institutions would mitigate risks associated with sudden withdrawal demands from depositors, thereby ensuring their operational viability. This is consistent with research that shows a strong correlation between liquidity levels and financial performance. MFBs that successfully handle their liquidity are more likely to achieve long-term profitability while still meeting regulatory standards. Ultimately, the theory provides a framework for understanding how liquidity management practices can influence the financial health of MFBs in Kenya, highlighting the need for strategic asset management in their operations. This theory supports liquidity regulation's objective.

2.3 Empirical Review

The survey examined how several reviews on capital regulations, credit regulation, liquidity regulations financial performance in this segment.

2.3.1 Capital Regulation and Financial Performance

Wanjiru (2016) looked at how regulation affects the finances performances of Kenya micro-financial banks. The study's targeted demographic was thirteen Kenyan micro financial banks. The research looked at regulatory theory, capture theory, and economic theory of regulation. From 2011 to 2015, secondary data was garnered from the microfinance organizations' finance records in Kenya. Returns on asset and returns on equity were both influenced by capital sufficiency, with return on asset being positively impacted, based on the study. Stakeholder theory, capital buffer theory, and liquidity shiftability theory were all discussed in this research.

Using financial results of commercial institutions registered on the NSE, implications of Kenyan Central Bank rules were investigated by Ndolo (2017). The investigation used secondary data collected between 2012 and 2016 from Kenya's eleven (11) publicly traded commercial banks. Primary data was assessed with descriptive statistics and panel data. For the time period analyzed, capital adequacy laws were found to have a substantial negative connection with bank performances. Listed commercial banks were considered previously, this research was on Kenyan microfinance banks. Hence addressing the contextual gap in literature. Commercial banks notably operate based on larger operation scales when compared to microfinance banks.

David and Muendo (2018) studied the effects of laws from CBK on results of the microfinance institutions financially. The study's intended audience was thirteen microfinance institutions that Central Bank of Kenya was in charge of as of December 31, 2016. All 82 personnel in the risks, legal compliances, and financial divisions of the entire Kenyan microfinance' banks were taken as variables for the population census sample. Primary and secondary data was both utilized for the inquiry. According to the report, capital adequacy has a big impact on how well microfinance firms operate financially. This study employed the use of secondary and primary data even though it was primarily concerned with Kenyan microfinance banks while secondary data was used for the present investigation which was taken from microfinance banks' financial statements. Secondary data notably is considered as a more objective form of data as compared to primary data.

Akims and Akims (2019) looked into how prudential requirements affected the profitability of commercial establishment listed on Kenya's NSE. Data for the investigation, which covered the years 2013-2017, was obtained from commercial banks of Kenya that are publicly traded. The project utilized regression panel techniques. Paper results claims that commercial banks with stock trading on Nairobi Securities Exchange in Kenya have shown capital adequacy regulations has considerable favorable impact on profitability. This study concentrated on Kenyan microfinance institutions.

Ahmed, Qasim, and Rashid (2020) examined how market regulation and capital regulation affect the capital-to-risk-weighted assets ratio. From 2009 to 2018, we used panel data from banks in Asian emerging nations. Data from seventy-three banks in Indonesia, Pakistan, Jordan, Saudi Arabia, the Philippines, and Thailand's financial statements were the source of our data collection. In order to examine the outcomes, the investigation employed the Generalized Method of Moments (GMM). The survey discovered market discipline and capital regulation have a big impact on the capital ratio in emerging Asian nations. The generalized method of moments was applied; this survey used multiple linear regression.

Mbaeri, Uwalake, and Gimba (2021) sought to establish how traded commercial banks in Nigeria performed in terms of return on capital employed from 2014 to 2019. The sampled commercial banks' yearly financial statements provided the data for this study, which was evaluated using panel regression. It was established that the capital adequacy ratio greatly and positively influences the return on the capital used in Nigeria's registered commercial banks. This conclusion suggests that the CBN raise the capital adequacy ratio of commercial financial institutions and make sure that it is adhered to. This is anticipated to result in enhanced performance for the banking industry. The study was measured by capital adequacy ratio, this study was measured using total equity and total assets.

2.3.2 Credit Regulation and Financial Performance

Ngumo, Collins, and David (2017) investigate factors influencing finance performances of Kenyan microfinance establishments financially. The study employed a descriptive research methodology from 2011 to 2015 and collected secondary information from seven microfinance organizations over a five-year period. The data were examined using regression analysis and correlation. Credits risks and financial’ performances of Kenyan microfinance banks were shown to have a minor negative association, according to the study. Although performed in Kenya, the research evaluated seven MFBs instead of the five banks that will be analyzed in this study.

Financial results of commercial banking institutions on the Nairobi Securities Exchange and implications of Kenyan Central Bank rules were determined by Ndolo (2017). The investigation used secondary data collected between 2012 and 2016 from Kenya's eleven (11) publicly traded commercial banks. The data was evaluated with descriptive method of statistics and panel data method. A minimally weak bond between the regulation of credits risks managements has been demonstrated. The focus of this research was on Kenyan microfinance banks.

The consequences of prudential regulations on bank performances in Kenya were investigated by Mohamed, Mutegi, and Muriuki (2017). The study's focus is on Kenya's forty-three commercially owned banks. The outcomes of the research, which were based on a cross-sectional paradigm and multiple regression analyses, show that credit managements of risks greatly enhanced the performances of banks in Kenya. The current study used secondary data as data source from microfinance establishments in Kenya.

Akims and Akims (2019) noted that prudential laws had an impact on financial performances of commercial’ institutions that were registered on Kenya's NSE. Data for the inquiry, which covered the years 2013 to 2017, was gathered from Kenya's publicly traded commercial institution. The investigation made use of panel regression techniques. The profitability of commercial establishments registered on Kenya's NSE is unaffected by liquidity restrictions, it has been determined. The risk of credit regulation has been depicted to having significantly detrimental effects on profitability of commercial establishments listed on NSE. This study concentrated on Kenyan microfinance institutions.

Bank of Africa (U) Ltd.'s financial results and credit risk management are related, according to Catherine (2020). With the help of a case study technique, the study combined qualitative and quantitative methods. The investigation revealed that the bank has attempted to geographically expand, not only within the country but also into neighboring countries like Tanzania, despite the fact that many loans are given out to various locations within the country. With 14 up country and 21 in the middle, the bank has more than 35 offices spread out over the nation. By setting the parameters for successful credit control, comprehensive credit research gives businesses a competitive edge in a cutthroat industry. The adjusted R Square value was 0.978 with a 95% level of confidence, indicating that variations in client appraisal, credit risk administration, and diversification of risks were responsible for a variation in the lender's performance of 97.8%. The study suggests that the management of the Bank ought to regularly assess its risk management strategies to see if they still hold up in light of its working environment's constant change, such as the present governing structures. This study utilized descriptive research methodology and case study approach.

According to credit risk, particularly non-performing loans, Kwashie (2022) evaluated the financial health of Ghana's commercial banking sector. Financial performance is evaluated using the returns on assets and financial benefit contributed. Also considered are internal bank criteria, such as the bank's age and size. The GDP, price increases, and fiscal policy setting are macroeconomic issues considered. The study utilized of panel data collated between 2013 and 2018 from fifteen major banks in Ghana. Results of the random effect estimate method demonstrate that NPLs have an adverse effect on both financial performances measures. It is recommended that commercial banks embrace rigorous credit risk control regulations that ought to be revised on an ongoing basis to direct their decisions and procedures for issuing financing as well as track credit risk, according to the adverse correlation among non-performing loans and their financial health. The study used time period from 2013-2018, this study timeframe was from 2015-2022.

2.3.3 Liquidity Regulation and Financial Performance

Wanjiru (2016) determined to reveal impacts of regulations on the monetary results of Kenyan microfinance institutions. Thirteen Kenyan microfinance banks were the study's target audience. In the study, regulatory theory, capture theory, and the economic theory of regulation were examined. From 2011 to 2015, secondary data was gathered from the microfinance organizations' financial records in Kenya. The research demonstrated that liquidity has detrimental effects on both returns on asset and returns on equity. Stakeholder theory, capital buffer theory, and liquidity shiftability theory were all discussed in this research.

Ndolo (2017) investigated implications of Kenyan Central Bank rules on financial results of commercial establishments represented on the NSE. Secondary data collated from Kenya's eleven (11) publicly traded commercial institutions between 2012 and 2016 was utilized in the inquiry. Descriptive statistical techniques and regression models for panel data were utilized in data analysis. A negligibly positive effect on the financial viability of the GDP of Kenya publicly traded commercial banks was found to have resulted from the regulation of liquidity management. Kenyan microfinance banks were the subject of this study.

Amina and Fedhila (2018) researched into how Tunisia's banks performed in relation to prudential regulation. The investigation covers all publicly traded Tunisian commercial banks from 2001 to

2016. The study found that the liquidity ratio significantly increases returns on assets and somewhat decreases returns on equity. Although Tunisia was utilized as a case study, emphasis of this investigation was Kenyan microfinance institutions.

Akims and Akims (2019) explored how prudential regulations affected profitability of commercial institution registered on Kenya's NSE. Data for the investigation, which covered the years 2013-2017, was obtained from commercial banks of Kenya that are publicly traded. The analysis was performed using a panel of regression data. It was determined that limiting access to liquidity had no effects on profit levels of commercial financial institutions registered on Kenya's NSE. This study concentrated on Kenyan microfinance institutions.

The determination of liquidity managements on financial performances of commercial establishments in Pakistan was investigated by Alim, Ali, & Metla (2021). In order to fulfill its financial objectives and maintain stability, the Pakistani financial market is significantly dependent on the banking industry. Consequently, the whole economy of the nation is profoundly influenced by the success of the banking industry. The Pakistani central bank makes sure institutions retain an ideal liquidity position to gain the greatest advantages and boost returns so as to fulfill its demand for security. Employing panel data and Ordinary Least Square analysis, the implications of managing liquidity risks on financial performances is examined in this study. Financial data for all commercial banks that functioned in Pakistan from 2006-2019 was compiled using archived data from the websites of the State Bank of Pakistan. Increased liquidity is found to boost banks' operations in Pakistani commercial banks. This survey collected Kenyan microfinance banks data in place of the study's data collection from Pakistani banks.

Eseoghene & Adelegan (2023) examined implications of liquidity managements on financial performances of Nigerian deposit money banks using 2011-2020 time-series data. After determining best estimate from the pool OLS, fixed impact, and random-effects estimates, the connection among the deposit to assets ratio and returns on assets of DMBs in Nigeria is statistically significant, but not sufficiently significant to be regarded as noteworthy, even though the P-value of 7.9% is more than the threshold for significance of 5%. There is a negative yet not statistically noteworthy relationship between the loan deposit proportion and the net interest margins of deposit-taking banks in Nigeria, with P value of 91.8% being less than 5% significant level. The Nigerian banks that accept deposits were the subject of the study. This investigation focused on Kenyan microfinance institutions.

2.4 Summary of Literature and Research Gaps

This segment includes practical researches that are reviewed, the gaps identified, and how the identified gaps are filled.

Table 2.1: Summary of Literature Review and Research Gaps

Research/Year	Title	Findings	Research Gaps	Addressing Research Gaps
Akims and Akims (2019)	Effects of prudential regulations on profitability of commercial banks listed at the NSE, Kenya.	Liquidity regulation has a minor unfavorable impact on commercial bank profitability.	Regression analysis was performed, and it was centered on commercial banks.	The research concentrated on microfinance banks in Kenya and both regression and correlation

				analysis was used.
Amina and Fedhila (2018)	Effects of prudential regulation on performances of banks in the Tunisian.	Return on assets is significantly influenced by the liquidity ratio, but return on equity is only marginally influenced.	The research was conducted on banks in Tunisia	The current research emphasized on MFBs in Kenya
Akims and Akims (2019)	Regulation that are prudential effect on Kenyan listed banks that are commercial profitability	Credits risks regulation significantly inversely affected profitability of the banks	The research concentrated on commercial banks and regression analysis was used.	The current study focused on microfinance banks in Kenya and both regression and correlation analysis was used.
Mohamed, Mutegi and Muriuki	Prudential Guidelines effect on bank	In Kenya, credit risk management has favorable	The research focused on Kenyan	The current research concentrated on

(2017)	performance in context of Kenya.	impacts on bank performance.	commercial banks	Kenyan microfinance banks
Ndolo (2017)	effects of CBK's regulations on financial performances of commercial banks publicly traded at NSE, Kenya	The performances of Kenya's listed commercial banks had a negligible positive link with liquidity management regulation.	The research was dependent on Kenyan commercial banks.	The current research focused on Kenyan microfinance banks
Akims and Akims (2019)	Effect of prudential regulations on profitability of commercial banks listed at the NSE, Kenya.	Credit risk regulation had a significant negative effect on profitability of the selected commercial banks	The research focused on commercial banks and regression analysis was used.	The current study focused on MFBs in Kenya and both regression and correlation analysis was used.

Wanjiru (2016)	Influences of regulation on the financial performance of microfinance banks in Kenya.	Return on asset was positively impacted by capital adequacy, whereas return on equity was negatively impacted.	The research employed Theory of regulation, capture theory and economic theory of regulation	The current research utilized stakeholder theory, capital buffer theory and liquidity shiftability theory
Akims and Akims (2019)	Effect of prudential regulations on profitability of commercial banks listed at the Nairobi Securities Exchange, Kenya.	It was found that Commercial banks listed on Kenya's Nairobi Securities Exchange had to a considerable negative impact on their profitability as a result of credit risk regulation.	The study focused on commercial banks and regression analysis was used.	The current research focused on microfinance banks in Kenya and both regression and correlation analysis was used.

Source: Researcher (2024)

2.5 Conceptual Framework

Diagrams illustrating the relationships concerning explained and explanatory factors are made using this technique. The explained factor is financial performances, and the independent variables were taken into consideration such as capital regulation, credit regulation, and liquidity regulation.

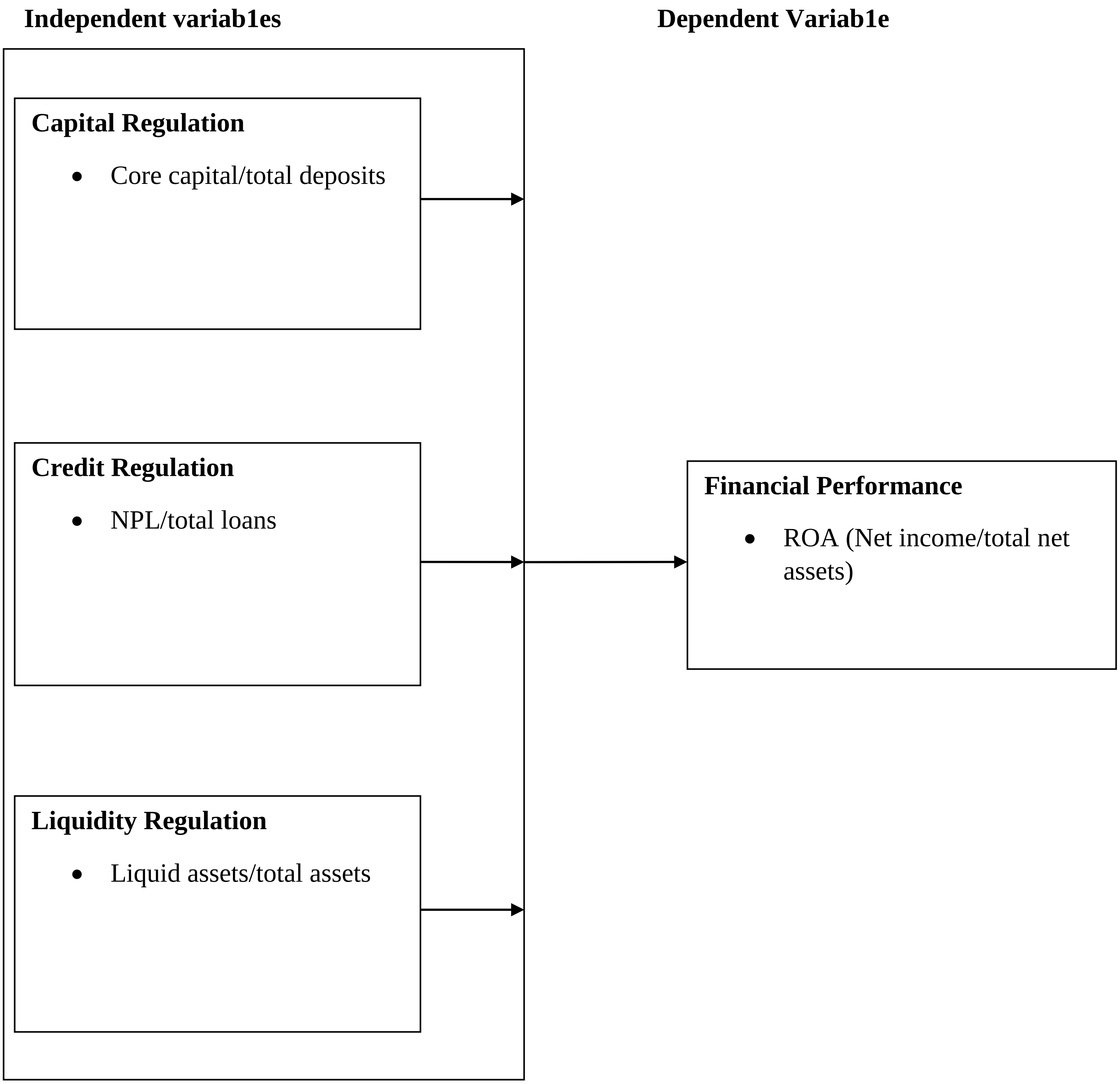

Figure 2.1: Conceptual Framework
Source: Researcher (2022)

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This section addresses the study's research design, population target, sample and sampling methods, research tools, data collection strategies, and analysis procedures.

3.2 Research Design

A research design is a methodical blueprint that delineates the procedures and strategies that will be used to carry out a research investigation. It functions as a comprehensive plan for the whole of the research procedure, including the specific procedures and strategies that will be used to gather and examine data. An intricately designed research plan is essential to guarantee the achievement of research goals and the production of genuine and dependable outcomes. (Salkind, 2010). A researcher can use a design as a plan to answer the questions that a study is seeking to answer (Mugenda & Mugenda, 2013). The study, which is quantitative in nature used explanatory survey design. Explanatory research design as define by Bentouhami, Casas and Weyler (2021) is a systematic approach to investigating the causes and effects of phenomena, aiming to provide a deeper understanding of why and how certain events occur. This type of research is mostly useful when existing data is limited, and it seeks to clarify relationships among variables, often framed within a "cause and effect" model (Bespala, 2023). The survey gives the researcher the chance to look into how Kenya's performance of banks is impacted by prudential requirements. The choice was made on the premise that explanatory designs are the most efficient in investigating the effects of independent variables on dependent variables without altering the element being explained (Bell, 2017).

3.3 Target Population

Target population comprises of everyone in the designated area on which the researcher desires to base his or her results. As a result, all fourteen (14) licensed microfinance establishment in Kenya controlled by CBK was included in the research population (CBK, 2019).

3.4 Sampling Design

A sample is a subset of population, studied for its features in order to comprehend the population as a whole. A census approach was used because the study's sample consisted of the 14 licensed microfinance institutions. Several microfinance institutions exist, including Faulu MFB Ltd, Uwezo MFB Ltd, Rafiki MFB Ltd, Kenya Women MFB Ltd and Century MFB Ltd. For the purpose of seeing their financial statements and evaluating their financial performance, the microfinance banks selected for consideration had to be in operation for at least five years. These Microfinance Banks were chosen because they meet these criteria, have been in business for more than 5 years, and have easily accessible financial statements. The investigation was between 2015 and 2022.

3.5 Empirical Model

In the analysis, a correlation and multiple regression model was used. The result of financial performance was expressed as a function of prudential regulations (capital, credit and liquidity regulation).

$FP = \beta_0 + \beta_1 CALR_{it} + \beta_2 CRR_{it} + \beta_3 LIR_{it} + \varepsilon$

Where:

CALRit = Capital regulation

CRRit= Credit regulation

LIRit = Liquidity regulation

βo = Constant

βo-β_3 = Beta Coefficients

Ɛ = Error term

3.6 Operationalization and Measurement of Variables

The methods by which the constructs of the study was measured and operationalized are documented below:

Table 3.1: Operationalization and Measurement of Variables

Variable	Type	Operationalization	Measurement
Financial Performances	Dependent	The profit yielded by every shilling invested in assets as well as acquired by a firm.	ROA: Net income/total net assets
Capital regulation	Independent	This is determined by the total equity of the bank	Core capital/total deposits
Credit regulation	Independent	This expressed by overall liability of the bank	NPL/total loans
Liquidity regulation	Independent	Maintenance of adequate levels of liquidity to meet their short-term financial obligations	Liquid assets/total assets

3.7 Data Collection Instrument and Procedure

The secondary data was employed in this investigation. Data is garnered from selected Kenyan microfinance banks' financial statements. The information gathered over the last seven years (2015-2022) assisted the researcher in analyzing their financial performance in comparison to the independent variable (capital regulation, credit regulation and liquidity regulation).

3.8 Data Analysis and Presentation

The information is evaluated so that the researcher may decide whether or not the research hypotheses are correct. Because it is simple to use and best suited for studying management-related attitudes, the SPSS computer software was used (Martin and Acuna, 2015). To explore the information, descriptive statistics was employed. The magnitude to which prudential regulation affects financial performance and the linkages between the two was also be examined using multiple regression methods. Tables and graphs were utilized to display analysis results.

3.9 Diagnostic Tests

To make sure the data is suitable for analysis, diagnostic assessments are performed in research. The survey included normality, collinearity, stationarity and Hausman tests.

3.9.1 Stationarity Test

It is deemed stationary when mean, variance, or pattern of a series of values does not exhibit a trend that is either upward or downward. The progression is non-static in null hypothesis instance, whereas series is static in alternative hypothesis. A non-static data collection yields inaccurate outcomes. If statistical p-value is lower than 0.05, which reveals no variability of data set, null hypothesis is rejected. The Fisher-type test was utilized.

3.9.2 Test for Correlation

Establishing the degree of significance of an interaction between two variables is done using the correlation test. Green (2008) asserts that multicollinearity is absent when a pair of variables' correlations is -0.8 or 0.8 (i.e., when their r2 is 64% or higher). Tight relationships are thus indicated. Therefore, variance inflation factor was utilized with a threshold of 5.

3.9.3 Normality Test

When conducting research, a normality test is used to make sure data is split properly. The conclusions drawn from data that are not evenly distributed may be false. Green (2008) asserts that the second hypothesis, which is more likely, asserts data has a regular dispersal while the null hypothesis claims they are not. Data that has a p-value less than 0.05 is considered abnormal, whereas data that has a p-value more than 0.05 is regarded as normal. The survey used the Shapiro Walk Test in this examination.

3.9.4 Hausman Test

Hausman test is utilized to identify which model is fitting the most for a regression panel's results. The null hypothesis for the selected model is that it has no fixed effects; alternative hypothesis is that it has a fixed consequence. Because null hypothesis cannot be supported when p-value is less than 0.05, fixed effect models was applied.

3.10 Ethical Consideration

The survey utilized codes rather than names to preserve anonymity. Encryption key entry mechanisms was used to safeguard all local files. Only the researcher and supervisors had access to the data. Forms and lists that link participants' ID numbers to other identifiable details was kept in a closed file in a secure location.

CHAPTER FOUR

DATA ANALYSIS AND DISCUSSION

4.1 Introduction

This section delved into the assessment and discussion of the research data. The primary objective of this chapter is to thoroughly examine the collected data, extract significant insights, and engage in an in-depth conversation regarding the obtained results. Within this chapter, the survey provided a concise overview of the dataset, highlighting its characteristics and offering insights into the demographics of the sample. Furthermore, the survey elucidated the employed data analysis methods, elucidating the processes and transformations applied to facilitate meaningful interpretation. Moreover, the analytical approach was guided by the objectives, resulting in specific outcomes that were compared to prior findings.

4.2 Descriptive Analysis

Descriptive analysis is essential in the process of data analysis by summarizing and elucidating the primary attributes, patterns, and developments observed within the data. Its purpose is to arrange, present, and interpret data in a manner that enhances comprehension of the research variables. The resulting information encompasses statistical measures such as means, standard deviations, as well as minimum and maximum values, which are documented and explained. The specific outcomes of this analysis are displayed in Table 4.1.

Table 4.1: Descriptive Results

Variable	Obs	Mean	Std. Dev.	Min	Max
Financial Performance	104	-.0794224	.128985	-.5838218	.0466136
Capital Regulation	104	.0029088	.0089651	-.0100599	.0576592
Credit Regulation	101	.3840177	1.583919	0	16
Liquidity Regulation	104	.2813588	.1609521	.0654206	.926097

Source: Study Data (2024)

The outcome of the survey as depicted in Table 4.1 uncovered that a mean of -0.0794224 value associated with financial performance and a standard deviation of 0.128985. The lowest and highest values recorded for financial performance are -0.5838218 and 0.0466136. The mean value of -0.0794224 denotes that, on average, microfinance banks in Kenya have a negative financial performance. This indicates that, as a group, these banks are facing challenges in generating profits and achieving positive financial outcomes. It suggests that their expenses may be exceeding their revenues, resulting in financial losses. The deviation of 0.128985 standards indicates the extent of variability or dispersion in the financial performance values across the observed microfinance banks. A relatively moderate standard deviation suggests that there is a certain level of consistency in the financial performance among the surveyed banks. These statistics indicate that, on average, microfinance banks in Kenya have a negative financial performance, with some variations observed among the banks. This implies that within the time frame of the survey, the microfinance banks have witnessed losses.

The outcome displayed that capital regulation has a mean value of 0.0029088, with a standard of 0.0089651 deviations. The mean value of 0.0029088 suggests that, on average, microfinance banks in Kenya maintain a balanced approach to capital regulation. This indicates that these banks have implemented measures to ensure they have an appropriate level of capital in relation to their risk exposure, allowing them to absorb potential losses and maintain financial stability. The standard of 0.0089651 deviations signifies the extent of variability or dispersion in the capital regulation values across the observed microfinance banks. A relatively low standard deviation suggests that most banks exhibit similar levels of capital regulation, indicating a certain level of consistency in their capital management practices. The smallest and upper limit values for capital regulation are -0.0100599 and 0.0576592. These figures suggest that microfinance banks in Kenya generally comply with capital regulations, as the mean value is close to zero, indicating a balanced capital position. The outcome contradicts the threshold set by the CBK of 14.5% indicating that microfinance banks in Kenya operate far below the capital regulation of CBK. This implies that microfinance banks in Kenya are vulnerable to the economic and financial risk hence affecting their financial performance.

The credit regulation utilized in the survey has a mean value of 0.3840177 and a relatively high standard of 1.583919 deviations. The mean value of 0.3840177 indicates that, on average, Kenya's banks of microfinance utilize a certain level of credit regulation. This suggests that these banks have implemented measures and policies to govern their lending activities and manage credit risk. The relatively high standard deviation of 1.583919 suggests a considerable degree of variability or dispersion in the credit regulation values across the observed microfinance banks. This indicates that different banks have adopted varying levels of credit regulation, resulting in a wide range of approaches to managing credit risk and overseeing lending practices. The minimum value is 0, while the maximum value is 16. These results imply that there is significant variation in credit regulation among microfinance banks in Kenya, with some banks having much higher levels of credit regulation compared to others. The range of credit regulation operational within the microfinance banks in Kenya is below the threshold of 25% implying that these banks ability to give out credits to their target audience is limited.

Furthermore, liquidity regulation was observed to have a mean value of 0.2813588, with a deviation of 0.1609521 standards. The standard deviation of 0.1609521 signifies the extent of variability or dispersion in the liquidity regulation values across the observed microfinance banks. A relatively low standard deviation implies that most banks exhibit similar levels of liquidity regulation, indicating a certain level of consistency in their liquidity management practices. The least and highest values for liquidity regulation are 0.0654206 and 0.926097. These statistics indicate that microfinance banks in Kenya generally maintain a moderate level of liquidity regulation, with some banks exhibiting higher liquidity regulation than others. Therefore, these banks have implemented measures to ensure they have a reasonable amount of liquid assets available to meet their short-term obligations. The outcome indicated that these banks have operational liquidity that falls above the minimum of at least 20% set up by the CBK. This implies that the banks are capable of meeting their short term obligations without stress as evidenced in 28% average mean score.

4.3 Diagnostic Test Results

Diagnostic tests in regression analysis are utilized to evaluate the validity of the underlying assumptions and to identify potential issues or problems with the regression model. These tests help ensure the reliability and accuracy of the regression results. To ensure the validity of the outcomes, the survey conducted the following tests which include normality, multicollinearity, autocorrelation, heteroscedasticity tests.

4.3.1 Stationarity Test Results

Stationarity refers to the circumstance where the mean, variance, and covariance structure of a time series remain unchanged. Non-stationarity implies that the series properties evolve over time, making it difficult to establish stable relationships and reliable regression results. Understanding the distinction between level stationarity and difference stationarity is of utmost importance in time series analysis to achieve precise modeling, as elaborated by Hamilton (1994). The process of converting non-stationary series into stationary ones through transformation is a vital procedure to guarantee dependable outcomes. The Fisher-Type test was utilized to assess stationarity as obtained in Table 4.2.

Table 4.2: Fisher-Type Test Results

Variable	Statistic	P-value	Comment
Financial Performance	103.2191	0.0000	Stationary
Capital Regulation	368.5694	0.0000	Stationary
Credit Regulation	67.8521	0.0000	Stationary
Liquidity Regulation	78.8675	0.0000	Stationary

Source: Study Data (2024)

The Fisher-Type test result indicates that the variables of Financial Performance, Capital Regulation, Credit Regulation, and Liquidity Regulation are all found to be stationary. The test statistic values for each variable (103.2191 for Financial Performance, 368.5694 for Capital Regulation, 67.8521 for Credit Regulation, and 78.8675 for Liquidity Regulation) are significantly large, indicating strong evidence against the null hypothesis of non-stationarity. The p-values associated with each variable (0.0000 for all) are extremely small, suggesting that the observed test statistics are unlikely to occur by chance under the assumption of non-stationarity. Consequently, the null hypothesis of non-stationarity is rejected, and it can be concluded that these variables exhibit stationarity. Conclusively, all the variables are stationary, indicating that they possess stable statistical properties that are effectively utilized in time series modeling and analysis.

4.3.2 Multicollinearity Test Results

Multicollinearity occurs when there is a high connection among the independent factors in the model. Multicollinearity can lead to unsteady and undependable coefficient estimates. Cohen, Cohen, West, and Aiken (2003) explained that multicollinearity can inflate the standard errors of the model's coefficients, creating difficulties in determining the individual effects of the correlated factors. This emphasizes the importance of detecting and addressing multicollinearity to ensure valid interpretations of the regression model. Commonly used tests include variance inflation factor (VIF) which the survey utilized with the outcome illustrated in Table 4.3.

Table 4.3: VIF Results

Variable	VIF	1/VIF
Capital Regulation	1.03	0.969587
Credit Regulation	1.00	0.996206
Liquidity Regulation	1.04	0.996206
Mean VIF	1.02	

Source: Study Data (2024)

The outcome uncovered that all the VIF values are less than 5: 1.03 for capital regulation, 1.00 for credit regulation, and 1.04 for liquidity regulation. These values indicate a relatively low level of multicollinearity, suggesting that the factors are not highly correlated with each other. The reciprocal values (1/VIF) provide another perspective on the severity of multicollinearity. Smaller values of 1/VIF indicate a higher degree of multicollinearity. This outcome noted that the values are slightly higher confirming the notion that multicollinearity is not a significant issue among the variables. The mean VIF value of 1.02 represents the average VIF across all the variables. Since it is close to 1, it suggests that the overall multicollinearity among the variables in the regression model is relatively low thus, the result indicates that multicollinearity is not a major concern among the variables.

4.3.3 Normality Test Results

Normality is an assumption that states the residuals or errors of the regression model are normally distributed. The normality assumption is important because it allows for valid statistical inference. Violation from the normalcy assumption may result in distorted parameter estimates, inaccurate standard errors, and faulty inference. The Shapiro-Wilk test was utilized unveiling Table 4.4 outcomes.

Table 4.4: Shapiro-Wilk Test Results

Variable	Obs	W	V	z	Prob>z
Financial Performance	104	0.75503	20.900	6.758	0.00000
Capital Regulation	104	0.50752	42.016	8.310	0.00000
Credit Regulation	101	0.14435	71.235	9.469	0.00000
Liquidity Regulation	104	0.89398	9.045	4.896	0.00000

Source: Study Data (2024)

In this particular result, all the variables exhibit extremely low p-values (0.00000), which suggests strong substantiation against the null of normality. The W, V, and z statistics also have large absolute values, indicating significant departures from normality for each variable. The conclusion arrived is that the residuals or errors associated with the regression models for Financial Performance, Capital Regulation, Credit Regulation, and Liquidity Regulation do not follow a normal distribution. The departure from normality indicates skewness, heavy tails, or other non-normal characteristics in the distribution of the errors. However, Kutner, Nachtsheim, Neter, and Li (2005) poignantly stated that regression analysis can still provide valid estimates of the regression coefficients, even when the normality assumption is violated. They emphasize that the primary focus should be on the consistency and unbiasedness of the estimates rather than the normality of the residuals. In view of the sample size which is large and above 30, the residuals are said to be normality distributed.

4.3.4 Heteroscedasticity Test Results

Heteroscedasticity refers to a violation of the assumption of homoscedasticity in regression analysis. Homoscedasticity suggests that the variability of the residuals or mistakes remains consistent across all levels of the explanatory variables. In the case of heteroscedasticity, the variability of the residuals differs across the range of the independent variables, leading to unequal spread of the residuals. To assess the existence of this, Breusch-Pagan test was adopted and the outcome is displayed in table 4.5.

Table 4.5: Breusch-Pagan test Results

Breusch-Pagan / Cook-Weisberg test for heteroskedasticity
Ho: Constant variance
Variables: fitted values of Financial Performance
chi2(1) = 1.14
Prob > chi2 = 0.2860

Source: Study Data (2024)

The outcome unveiled 1.14, with probability associated of 0.2860. Therefore, the p-value (0.2860) is above the commonly used 0.05significance threshold, the survey failed to annul the hypothesis. This suggests insignificant evidence of heteroscedasticity in the regression model. Therefore, there is insignificant departure from the assumption of constant variance for the residuals of the financial performance variable in the regression model. This suggests that the variability of the residuals remains generally constant across various levels of the financial performance indicator.

4.3.5 Autocorrelation Test Results

The axiom of autocorrelation was examined in this survey to unravel the existence of residual linkages at different points in time. The existence of this introduces inefficiency and inconsistency in the estimation of the regression coefficients. Furthermore, it results in underestimation of the standard errors, leading to hypothesis tests and confidence intervals that are invalid. To investigate the presence of autocorrelation, the Breusch-Godfrey outputs are exhibited in Table 4.6.

Table 4.6: Breusch-Godfrey test Results

Breusch-Godfrey Serial Correlation LM Test:			
F-statistic	0.183988	Prob. F(2,95)	0.8322
Obs*R-squared	0.389707	Prob. Chi-Square(2)	0.8230

Source: Study Data (2024)

The interpretation of this outcome is focused on the p-values associated with the F-statistic and the chi-square test statistic. In both cases, the p-values are relatively high (0.8322 and 0.8230). This implies insignificant evidence of the model's serial correlation presence based on the variables included. In other words, the test doesn't offer enough evidence to exclude the hypothesis of the absence of a series correlation. This indicates that the residuals in the regression model are likely independent and do not exhibit a systematic pattern over time.

4.3.6 Model Specification Results

Model specification refers to the process of selecting and defining the appropriate model that captures the relationships between variables in a panel dataset. When specifying a panel data model, it is crucial to carefully consider the precise research question, the nature of the data, and the underlying assumptions. According to Greene (2017), the Hausman test provides researchers with a means to select between fixed effects (FE) and random effects (RE) models by probing the linkage concerning individual-specific effects and independent variables. By addressing endogeneity biases, this test ensures the credibility of the estimated parameters. In relation to this, the test outcomes are in Table 4.7.

Table 4.7: Hausman Test Results

	(b) Fixed	(B) Random	(b-B) Difference	sqrt(diag(V_b-V_B)) S.E
Capital Regulation	-3.318468	-3.494246	.1757786	.3662286
Credit Regulation	-.0003152	-.0027033	.002388	.0008666
Liquidity Regulation	-.2173051	-.1973236	-.0199815	.0207888
Chi (3)	10.22			
Prob>chi2	0.0168			

Source: Study Data (2024)

As pointed out by the outcome, the coefficient for capital regulation is negative in both models. The difference between the fixed and random effects coefficients is 0.1757786, indicating a small deviation between the two models. The standard error associated with this difference is 0.3662286. Both the fixed and random effects coefficients for credit regulation are close to zero. The difference between the two coefficients is 0.002388, suggesting a small deviation. The associated standard error is 0.0008666. For liquidity regulation, both the fixed and random effects coefficients are negative. The difference between the two coefficients is -0.0199815, indicating a small deviation. The standard error for this difference is 0.0207888. The chi-square reported is 10.22, with a probability (Prob>chi2) of 0.0168. This suggests adequate evidence to refute the hypothesis of null that the random effects model is consistent and efficient as well as more suitable.

4.4 Regression Results

The data for the survey were subjected to regression analysis of the fixed effect model to determine the statistical significance of the factors in the survey. Applying this to the survey, the effect of prudential regulation was examined on the MFBs performance financially. The outcomes from the regression assessment are displayed in Table 4.8.

Table 4.8: Regression Results

ROA	Coef.	Std. Err.	z	P>z	[95% Conf.	Interval]
Capital Regulation	-3.318468	1.312408	-2.53	0.013	-5.928334	-.7086015
Credit Regulation	-.0003152	.0064578	-0.05	0.961	-.0131574	.0125269
Liquidity Regulation	-.2173051	.0799925	-2.72	0.008	-.376379	-.0582312
_cons	-.0101813	.0241542	-0.42	0.674	-.0582145	.0378519
R-Square	0.1276					
F(3,13)	2.90					
Prob > F	0.0754					

Source: Study Data (2024)

Output from the regression displayed an intercept value of -0.0101813. This term stands for the predictable performance financially when all the independent factors (regulations) are zero. The coefficient is not significant ($p > 0.05$), indicating that there is insufficient verification to suggest a significant linkage concerning the intercept and performance financially. The value of R-squared of 0.1276 detailed capital regulation, credit regulation, and liquidity regulation explain approximately 12.76% of the discrepancy in the explained factor (performance financially). The F-statistic of 2.90 with a corresponding p-value of 0.0754 unveiled that the overall model is marginally significant at the 0.05 level.

The coefficient for capital regulation is -3.318468. This indicates that an increase in capital regulation is related with a decrease in financially performed Kenyan microfinance banks. The negative sign suggests that stricter capital regulation requirements may have a detrimental effect on the banks that financially performed. The significant at the 0.05 level ($p < 0.05$) entails that capital regulation effect on performance financially is unlikely to have occurred by chance. The coefficient for credit regulation is -0.0003152. However, the insignificant ($p > 0.05$) drilled that there is insufficient evidence to conclude that credit regulation has a significant effect on performance financially. The near-zero coefficient suggests that credit regulation may not have a substantial impact on the banks performance financially. The coefficient for liquidity regulation is -0.2173051. This negative coefficient implies that stricter liquidity regulation is linked with a decrease in financial performance. The significant at the 0.05 level ($p < 0.01$) unveiled that the connection between liquidity regulation and performance financially is due to chance. It suggests that stricter liquidity regulations might have a adverse impact on the banks financially performance.

4.5 Hypothesis Testing and Discussion of Findings

This section focused on the survey that was carried out to test hypotheses. The main objective examined how prudential regulation affects the financially Kenyan microfinance performance banks. Specifically, the survey investigated the impact of capital regulation, credit regulation, and liquidity regulation on the banks financially performance. By conducting hypothesis testing, the survey aimed to determine whether these variables have an influence of significant on the performance of microfinance banks financially. The discussion of the outcomes included an evaluation of the implications and whether they aligned with or deviated from the initial expectations.

4.5.1 Capital regulation has no significant effect on financial performance of microfinance banks in Kenya

Based on the specific objective of determining capital regulation effect on the Kenyans' MFBs financially performance, the initial stated hypothesis put forth that capital regulation has an insignificant effect on performance financially. However, on the precise outcome related to this objective, the hypothesis of null was abandoned, demonstrating capital regulation extensively affects the performance financially of microfinance of Kenyan banks. This outcome can be attributed to microfinance banks maintenance of an appropriate level of capital to meet regulatory requirements and mitigate potential risks. The consistency of these findings is reflected in the work of Ndolo (2017), who observed a substantial negative linkage concerning capital adequacy regulations and bank performance. David and Muendo (2018) revealed that capital adequacy impacted significantly on the microfinance banks' financial operations of microfinance firms. Akims and Akims (2019) discovered that commercial banks with stock trading on the Nairobi Securities Exchange in Kenya experienced considerable favorable impacts on profitability as a result of capital adequacy regulations. Ahmed, Qasim, and Rashid (2020) unfolded that capital regulation has a big impact on the capital ratio in emerging Asian nations. However, the outcome is at variance with Mbaeri, Uwalake, and Gimba (2021) who disclosed that capital adequacy ratio greatly and positively influences the return on the capital used in Nigeria's registered commercial banks. The finding is incongruent with the capital buffer hypothesis, which suggests that banks maintain capital buffers above the statutory minimum to decrease the likelihood of breaching the capital requirement and suffering the related expenses. The capital requirements are set too high relative to the risk profile of microfinance banks, forcing them to hold excessive capital that cannot be efficiently deployed to generate returns. The outcomes variation could be attributed to the contextual difference arising from these investigations.

4.5.2 Credit regulation has no significant effect on financial performance of microfinance banks in Kenya

Based on the analysis conducted in this survey, which investigated regulation of credit effect on the Kenyan MFBs financial performance, the initially hypothesize notion was that credit regulation insignificant affect these banks performance financially. In light of the survey's findings, the null hypothesis was upheld, indicating that credit regulation has an insignificant effect on the financial performance of microfinance banks in Kenya. The outcomes may be ascribed to the low level of compliance by the banks with credit regulation, amounting in higher rate of defaulting of loans by borrowers and subsequently reducing the banks' profitability. These outcomes align with Ngumo, Collins, and David (2017), who discovered a minor negative association concerning credit risks and the microfinance performed banks financially in Kenya. Ndolo (2017) identified a minimally weak regulation of credits risks managements on financial performance. The variance of the outcome aligned with Mohamed, Mutegi, and Muriuki (2017) who discovered that credit managements of risks greatly enhanced the performances of banks in Kenya. Akims and Akims (2019) unearthed that risk of credit regulation has been depicted to having significantly detrimental effects on profitability of commercial establishments listed on NSE.

4.5.3 Liquidity regulation has no significant effect on financial performance of microfinance banks in Kenya

The survey was conducted the examination of liquidity regulation effect on the Kenya's MFBs. The theoretical proposition derived from this objective posited that liquidity regulation has an insignificantly effect on the banks financially performance. However, the survey's outcomes revealed that regulation of liquidity does indeed significantly affect Kenya’s microfinance financially banks’ performance, leading to the rejection of the hypothesis of null. The outcomes may be ascribed to the importance of microfinance banks maintaining optimal levels of liquidity to support their day-to-day operations, including loan funding, meeting deposit withdrawals, and managing cash flow. Insufficient liquidity can disrupt their operations, potentially lead to solvency issues, and compromise their ability to meet financial obligations. The findings of this survey align with previous studies, such as Wanjiru (2016), which highlighted the detrimental effects of liquidity on both returns on assets and returns on equity. Similarly, Ndolo (2017) uncovered that liquidity management regulations had a negligible effect on the financial viability of publicly traded commercial banks in Kenya's GDP. Amina and Fedhila (2018) discovered that liquidity ratios significantly increase returns on assets while somewhat decreasing returns on equity. Contradicting this outcome was Akims and Akims (2019) who noted that limiting access to liquidity had no effects on profit levels of commercial financial institutions registered on Kenya's NSE. The outcome of the investigation does not tally with the postulation of the liquidity shiftability theory which noted that Banks must ensure a proper equilibrium between liquid assets (which can be quickly converted to cash) and illiquid assets (which typically yield higher returns). The findings suggest that stringent liquidity regulations may not be well-suited to the operational realities of microfinance banks, which often operate on thinner margins than larger financial institutions. This misalignment can lead to inefficiencies and reduced financial performance, as these banks may be unable to shift resources effectively to optimize their liquidity and profitability. The measures and contextual difference could be linked to these outcomes providing unique outcomes tied to each of these contexts.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter presented an overview of the survey, focusing on its specific objectives. It summarized the survey's outcomes based on the factors investigated. These outcomes led to the formulation of conclusions drawn from the variables examined, along with recommendations aligned with the survey's objectives. By offering these conclusions derived from the precise survey objectives, this chapter made a valuable input to knowledge existing in the survey's field. Additionally, suggestions for further surveys were provided to explore the subject matter in greater depth.

5.2 Summary of Findings

The survey focused on analyzing prudential regulation effect on the performance of Kenyan MFBs financially. The researcher specifically investigated the effects of regulation on capital, credit, and liquidity on these banks' performance financially. To achieve these objectives, the survey employed panel regression analysis, and the results and findings from the survey are summarized in this survey.

5.2.1 Effect of capital regulation on financial performance of microfinance banks in Kenya

The purpose was investigation on how capital regulation affects the financial performance of Kenyan MFBs. In a hypothetical scenario, capital regulation does not have a noteworthy impact on the banks financially performance. However, the results indicated that regulation on capital indeed has a significant and unfavourable effect on their performance financially. Therefore, it can be inferred that implementing stricter capital regulation is linked to improved financial performance.

5.2.2 Effect of credit regulation on financial performance of microfinance banks in Kenya

Purposefully the survey investigated how credit regulation affects the Kenya' MFBs financially performed banks. Based on the objective, the stated hypothesis noted that credit regulation has no substantial impact on the performance financially. However, the results indicate that credit regulation insignificantly and adversely affect these banks outcomes financially. Consequently, it can be inferred that implementing stricter credit regulation is not associated with the microfinance financially banks performance.

5.2.3 Effect of liquidity regulation on financial performance of microfinance banks in Kenya

Primarily, the survey was to explore how liquidity regulation affect Kenya's MFBs performed financially in Kenya. The hypothesized notion put forward suggested that liquidity regulation does not play a substantial role in influencing the banks performance in Kenya financially. Nevertheless, the research outcomes unfolded that liquidity regulation does have a significant and unfavourable effect on the banks outcomes financially. This suggests that microfinance banks operating under more stringent liquidity regulations tend to exhibit superior financial performance.

5.3 Conclusion

The survey primarily examined how prudential regulation affects the MFBs that performed financially in Kenya. Precisely, the survey focused on assessing the regulation of capital, credit and liquidity effect on the banks performance financially. In relation to the specific objective of investigating the influence of capital regulation on the banks that financially performed, regulation of capital has a significant and negative impact on the microfinance financially performed banks in Kenya. The survey's conclusion highlighted that capital regulation plays a crucial role in shaping the banks performance financially in Kenya. By maintaining appropriate levels of capital, these banks can enhance their ability to absorb losses, mitigate risks, and safeguard depositors' funds.

Exploring the objective of how credit regulation influences the financial performance of MFBs in Kenya, the findings unveiled insignificant negative effect on the financially performed banks. Consequently, the survey concluded that credit regulation is not a significant factor in determining the performance of these banks financially. The results suggest that the specific credit regulation measures examined in the survey do not have a substantial impact on the outcomes of these banks financially. While credit regulation plays a key task in managing risks and promoting responsible lending practices, it appears that the regulatory measures scrutinized in this study do not exert a notable influence on the Kenyan microfinance financially performed banks.

The survey aimed to examine regulation of liquidity effect on the Kenyan MFBs financially performed. The findings pertaining to this objective indicate that liquidity regulation has a significant and adverse effect on the financially performed banks. Based on this outcome, the conclusion drawn is that, within the context of these banks, liquidity regulation serves an essential role in defining their overall financial health and profitability. Consequently, any changes made to the liquidity regulation would have a direct impact on these banks performance financially.

5.4 Recommendations

Considering the survey results, the recommendations were tailored to align with these findings, specifically focusing on factors that exhibited a significant impact on the financial performance of Kenyan MFBs. With this in mind, it is suggested that microfinance banks themselves should recognize the importance of capital management and ensure compliance with regulatory requirements. They should implement robust risk management practices, including regular monitoring of capital levels, stress testing, and strategic capital planning. By doing so, these institutions can enhance their financial performance, attract investors, and maintain the confidence of their stakeholders.

Microfinance banks should continue to focus on sound credit risk management practices regardless of the limited impact of specific credit regulations on performance financially. This includes implementing robust credit assessment procedures, monitoring loan portfolio quality, and maintaining effective collection and recovery mechanisms. By doing so, microfinance banks can mitigate credit risks, improve loan performance, and enhance their overall financial health.

Microfinance banks themselves should prioritize robust liquidity management practices and compliance with regulatory requirements. This includes maintaining diverse funding sources, monitoring liquidity ratios, and having contingency plans in place to address liquidity challenges. By doing so, microfinance banks can enhance their financial performance, manage risks effectively, and instill confidence in their stakeholders.

5.5 Contribution to Knowledge

This survey introduces notable advancements to the existing knowledge regarding the connection concerning prudential regulation and financial performance in Kenyan microfinance banks. Firstly, it extends the current literature by examining the impacts of prudential regulation on financial performance specifically within Kenya. Secondly, the survey transcends mere academic analysis and offers valuable insights that bear implications for both theoretical understanding and practical application. It enriches the theoretical foundations of relevant theories while also providing actionable implications for policymakers and microfinance bank management. Lastly, the research widens the scope of existing theories that link prudential regulation and financial performance, showcasing their relevance and adaptability within the distinctive landscape of Kenyan microfinance banks.

This study constructed a comprehensive and robust conceptual framework that establishes a clear linkage between prudential regulation and the Kenya's banks of microfinance performance financially. By employing rigorous empirical analysis, it deepened our understanding of the directional relationships among key factors, namely capital regulation, credit regulation, and liquidity regulation. The research yielded fresh insights into the intricate interplay of these factors, shedding light on their complex dynamics. Furthermore, the study made significant contributions to existing knowledge by formulating and empirically testing hypotheses that investigate prudential regulation effect of performance financially. Additionally, an empirical model incorporating the examined factors was derived, serving as a valuable tool for future research endeavours and offering potential applications in policymaking.

5.6 Suggestions for Further Studies

This survey delved into prudential regulation effect on the Kenya's MFBs financially performed, yielding valuable insights within this specific context. However, further avenues for research remain unexplored. Specifically, future studies could delve into the repercussions of Kenya's prudential regulation on commercial banks, providing a broader understanding of its effects across different sectors. Additionally, additional research efforts could focus on uncovering the underlying reasons behind the observed insignificance of credit regulation on financial performance. Such investigations hold the potential to deepen our understanding and facilitate the development of more robust models in this domain.

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APPENDICES

Appendix 1: Lists of Selected Microfinance Banks

- Caritas Microfinance Bank Limited
- Century Microfinance Bank
- Choice Microfinance Bank Limited
- Daraja Microfinance Bank Limited
- Faulu Microfinance
- Key Microfinance Bank PLC
- Kenya Women Finance Trust (KWFT)
- Maisha Microfinance Bank Ltd
- Muungano Microfinance Bank PLC
- Rafiki Microfinance Bank
- SMEP Microfinance Bank Limited
- Sumac Microfinance Bank Limited
- U & I Microfinance Bank Limited
- Uwezo Microfinance Bank

Appendix 2: Data Review Guide

Year	Capital regulation	Credit regulation		Liquidity regulation	Financial performance
2015					
2016					
2017					
2018					
2019					
2020					
2021					
2022					