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Portfolio Diversification and Financial Performance of Microfinance Institutions in Nairobi County, Kenya

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Abstract

Purpose: The current study sought to establish the effect of portfolio diversification on financial performance of microfinance institutions in Kenya. The study focused on establishing the effects of asset class diversification, risk profiling diversification, income diversification and locational diversification on performance of microfinance institutions in Kenya. The study was supported by Shiftability Theory, Capital Market Theory, Resource Based Theory and Balanced Score Card Theory.

Methodology: A descriptive research design was used and targeted 57 micro finance institutions operating in Nairobi County and registered under Association of Micro Finance Institutions. The unit of observation comprised of employees in top level management including chief financial officer, operational manager, and chief manager making a total of 171 respondents. The study employed a census approach. Both primary and secondary data were utilized in the study. Primary data was gathered using a five point Likert scale questionnaire while a secondary data collection sheet was utilized to collect secondary data from financial reports of the respective institutions. Both descriptive and inferential statistics was used to analyze the collected data. The statistics were generated through Statistical Package for Social Scientists and MS Excel.

Findings: The results were displayed in form of tables. The study established that portfolio diversification comprising of asset class, risk profiling, and income diversification positively and significantly affect financial performance of the MFIs operating in Nairobi County as shown by respective beta values of 0.318, 0.288 and 0.498 and significant values of 0.000, 0.005 and 0.000. This bears the implications that enhancing aspects of each of the portfolio diversification contributes to improved financial performance of the institutions. Locational diversification on the other had had a positive but insignificant effect on financial performance of the MFIs (beta=0.103,

sig=0.000>0.05) which implies that enhancing aspects of locational diversification contributes insignificantly to financial performance of the MFIs.

Unique contribution to theory, practice and policy: The study provided recommendations to the management of the MFIs to enhance the levels of asset class diversification, risk profiling diversification, and income diversification since the practices bears positive and significant effect on financial performances of the MFIs.

Key Words: *Asset Class Diversification, Risk Profiling Diversification, Income Diversification, Locational Diversification, and Microfinance Institutions*

Background of the Study

In developing countries, the roles of Micro-Finance Institutions (MFIs) cannot be overemphasized as they avail financial services to SMEs and households in low-income category who may not have prerequisite collaterals for securing loans (Janice, 2019). Due to the simplicity in funds accessibility, MFIs have proved to be very popular amongst low income groups and have played a significant role in alleviating poverty. This has seen a surge in the number of the institutions thus spurring intense competition for available markets. Additionally, the institutions face operational challenges associated with dynamisms in areas of operation, changes in regulations, dynamics in customers' demands and market changes. These challenges threatens the survival and performance of the institutions which have prompted them to capitalize on investing in different portfolios aiming at reducing risks (Xu *et al.*, 2015). A portfolio is a collection of investments that a firm or individual owns and comprises of stocks characterized by individual company investments, company investments such as bonds and collective investments such as mutual funds and unit trusts (Abouge, 2018). Additionally, a portfolio can be perceived as a group of assets that are viewed as financials in nature such as stocks, bonds and mutual funds. A firm's portfolio can be a composition of hedge funds, exchange traded futures and funds, equity funds, options and mutual funds, on the other hand, diversification is perceived as formulated strategy aiming at reducing risks through combining various investments (Phung & Mishra, 2016).

Portfolio diversification is the process of combining various assets aiming at reducing the general risk related with the entire organizational portfolio referred to as unsystematic risk (Thirathon & Meeprom, 2020). A well-mixed portfolio attained on different types of investments bears the capabilities of yielding high returns with reduced risks compared to individual investment thus creating a positive financial impact, performance and stability. Portfolio diversification has therefore become a norm in micro finance organizations aiming at identifying the best investment sets which can culminate into meaningful returns with associated low risks. Portfolio diversification can be assessed through indicators such as class diversification, income diversification, risk profiling diversification as well as Locational diversification (Neyens &Faems, 2013). A portfolio return solely depends on the risk and in order to minimize the risks

accompanying individual asset portfolio, micro finance institutions opts for diversification. In the diversification, portfolio assets are mixed with the portfolio aiming at maximizing returns while minimizing risks (Thirathon & Meeprom, 2020). The risk premium however varies from nation to nation and is particularly high in developing and emerging markets due to risk and volatility attached to such markets. Evaluation of portfolio returns on assets has remained one of the toughest financial challenge in the present times.

Statement of the Problem

The level of performance of micro finance institutions is a key indicator of financial stability that forms a basis for attracting and retaining clients. The microfinance institutions have however been posting dwindling performances as evidenced by increase in the levels of loan default rates standing and financial losses. Quarterly financial reports for the MFIs reveals an increase in the levels of loan default rates standing at 16% as of 2017 and NPLs increasing from Ksh 70.3billion in 2016 to Ksh 77.3billion in 2017 accounting for a 15% increase(AMFI, 2021). The report further shows that the institutions recorded a loss of $7.31million in 2017 compared to a loss of $ 3.77 million recorded in 2016. During the same period, the levels of customer deposit dropped to $394 in 2017 from a deposit of $401.9 recorded in 2016. The statistics shows that the institutions have been recording a downward trend in the levels of performances. These threatens the survival of the institutions which in long run renders them from contributing significantly to the economic growth through supporting growth of small scaled enterprises. The poor performances of the institutions can be enhanced through portfolio diversification which enables distribution of risks (Cesarone *et al.,* 2014). Through portfolio diversification, the institutions bears the capability of enhancing their performance levels since risk distribution ensures existence of various sources of income apart from the customer deposits and loans. The current study aims at establishing how portfolio diversification impacts MFIs financial performances in Nairobi County, Kenya. The study is further motivated by existence of research gaps from past studies in the theme of the current study. A study by Mohamad, Hassan and Sori, (2016) analyzed the implication of portfolio diversification on portfolio investments performance in Malaysia. The study was however conducted in Malaysia and focused on a different concept. A study by Clottey (2019) assessed how loan portfolio management affects sustainability and profitability of selected MFIs in Ghana. The study also focused on a different concept and was conducted in a different location. As study by Makau and Ambrose (2018) assessed how portfolio diversification impacts financial performances of NSE investment listed firms in Kenya. This study was however in the context of NSE listed firms. According to scholar's understanding, little research has been conducted on how portfolio diversification and financial performance of MFI's is influenced. Hence, the study sought to fill this knowledge gap by seeking answers to this research question; what is the impact of portfolio diversification on the financial performance of micro finance institutions in Kenya?

Objectives of the Study

i To determine the effect of asset class diversification on financial performance of microfinance institution in Kenya

ii To find out how risk profiling diversification affects financial performance of microfinance institutions in Kenya

iii To examine the effect of income diversification on financial performance of microfinance institutions in Kenya

iv To assess the effect of locational diversification on performance of microfinance institutions in Kenya

Research Hypothesis

i **H_{01}:** Asset class diversification has no significant effect on financial performance of microfinance institutions in Kenya
ii **H_{02}:** Risk profiling diversification has no significant effect on financial performance of microfinance institutions in Kenya
iii **H_{03}:** Income diversification has no significant effect on financial performance of microfinance institutions in Kenya
iv **H_{04}:** Locational diversification has no significant effect on financial performance of microfinance institutions in Kenya

Literature Review

Theoretical Review

Shiftability Theory

The theory was proposed in 1915 by Moulton and advanced in 2009 by Herbert. The theory suggests that liquidity of financial institutions is maintained if the assets in the institution are shiftable or can be converted into cash through selling to investors or other lending firms. Assets shiftability according to the theory implies the capability of moving a financial resource amongst financial establishments at agreed and negotiated prices. Liquidity of a financial institution depends on the institution's capability of moving assets to another individual through agreed prices. Mitchell (2006) notes that the theory revolves on the assumptions that financial institution's liquidity is sustainable through retaining assets that bear resale values or shiftability capability where they can be exchanged for cash to other investors, lenders or institutions in a short period of time. The theory bears the intentions of attracting the activities of financial institutions from credit to investments that tends to enhance the institution's level of liquidity. Financial institutions need to hold portfolios characterized with short term investments in the open market. Newlyn (2009) notes that when the investments are held in short terms, financial institutions are in a

position of meeting the customers' demands such as loans and cash withdrawals. In asset conversion into money through shiftability or sale, the involved transaction can only be possible when there are mutual agreements between the involved parties. Mitchell (2006) adds that shifting an asset is perceived as a simplistic act to the level where it can be shifted to an institution or individual. The main motivation from the theory is that the levels of liquidity held by financial institutions depends on the institution's capabilities of shifting the possessions to another party at an agreed predictable price. The theory is important in the study as it informs on the needs of financial institutions such as microfinances to diversify their assets in a way that the assets can be easily converted into cash at times of needs.

Capital Market Theory

Capital was proposed by Williams Sharpe in 1960 as to extend modern portfolio theory through formulating a model that attaches a price to all assets that are deemed risky. The theory acts as a representation of portfolios that combine returns and risks optimally. Shibasaki and Ehara (2021) adds that the theory represents all portfolios that merge risk free return rates with market portfolio of assets that are risky. Investors according to the theory chooses market line capital in equilibrium through lending or borrowing at risk free rates since there is returns maximization attached to a given risk level. Portfolios falling under capital market line (CML) optimizes the relationship between return and risk thus maximizing on performance. The Capital Asset Pricing Model formulated in the theory acts as a bridge between risk free return rate and point of tangency on the efficient frontier of optimal portfolios offering the highest expected returns attached to a defined risk level or the lowest risk associated with a certain level of expected return. Subrahmanyam (2012) adds that portfolios possessing best trade-offs the expected returns and risks lays on the tangent line. Finding market portfolio and the best market portfolio combination and assets with risk free tend to be separate problems. Investors either hold assets with risk free characteristics or combine market portfolio with the assets which solely depends on associated risk aversions. As an individual investor scales up the capital market line, the overall portfolio attached on the returns and risks increases. Investors characterized with risk-aversion selects portfolio that is close to risk free assets opting for low variance too high returns. On the other hand, investors characterized with less risk aversion prefers portfolios high in the capital market line which is attached to high expectations in returns but bears more risk. Through endeavoring to borrow funds in a risk free rate, the investors bears the capability of investing above 100% on their investable funds in the market portfolio which is risky thus increasing their expectations on risks and returns above the ones offered by the market portfolio. The study supports the risk profiling diversification where firms assess the risks associated with an investment. This gives the firm the opportunity of investing on the investments that bear positive returns to the investor.

Resource Based Theory

Wernerfelt (1984) proposed the Resource Based Theory, which makes the assumption that businesses make conscious managerial efforts to gain a lasting competitive edge over their rivals in the market. Firms can diversify their companies and enter new markets by gaining a competitive edge over their rivals. Additionally, by diversifying their business operations, firms tend to diversify their revenue, which leads to income diversification. According to Barney and Clark (2009), resource-based diversification may lead to economies of scope through the sharing of core competencies and activities, and can hence play a role in maintaining competitive advantage. A resources bundle's uniqueness or variety is viewed as a necessary condition for acquiring a competitive edge and therefore diversifying their revenue. According to the resource-based perspective of the firm, diversification develops when firms try to make use of firm-specific, non-tradable resources, such as human resources. The resource-based perspective theory often assumes that businesses are set up with a single product focus and deal with a uniform factor market. Based on such presumptions, a market power perspective of diversification places an emphasis on the advantages a company may gain at the expense of its rivals and clients. The usage and exploitation of already-existing resources are key factors in the success of business strategy. If firms possess underutilized resource pools, these provide special, firm-specific chances for exploitation (Chatterjee & Wernerfelt, 1988). Business diversification may be thought of as a process by which managers first identify resources that are distinctive to their firm and then choose which markets those resources can earn the highest returns. This is one such method for utilizing existing firm-specific resources. Some firms' resources are "indivisible" and so "sticky," making it difficult or impossible to exchange them on the market, especially if they are intangible. The argument is that if all enterprises in a certain market have comparable resources, then no strategy will work for one business and fail to work for the other businesses, making the resource-based theory an important factor in income diversification (Cool & Dierickx, 2002). The resource-based theory is relevant to this study because it recommends ways to diversify a firm's revenue streams by leveraging its resource capacity to enter new markets, or what is known as the sequential entry strategy (Chatterjee & Wernerfelt, 1988). This diversity of resource capacity will cause the firm's earnings, which is brought about by entering new markets, to diversify. Therefore, a firm's resource placement is advantageous not just by creating entry barriers but also by directly promoting diversity in related activities that reduce costs for the company and ultimately result in a diversification of income received.

Balanced Score Card Theory

Early in the 1990s, Kaplan and Norton (1992) developed the Balanced Scorecard theory after their studies revealed that a company's performance cannot be fully assessed from a financial perspective for two reasons: first, the financial perspective only provides information about the company's past status and cannot be trusted to forecast its present or future status. Second, the

impact of intangible assets is ignored by the financial measures used to assess financial performance since they focus on comparing the value of a company's assets to their market value. As a result, applying the financial viewpoint to evaluate contemporary firm performance proved unproductive, which led Kaplan and Norton to develop the balanced score card (BSC) model (1992). The BSC examines an organization's strategy from four balanced vantage points: finance, internal operations, customers, and employee development and growth (Kamakoty, 2018). The financial viewpoint considers how a firm should be financially in order to prosper. What financial ratios, for instance, should the company display to win over shareholders? The internal perspective is concerned with the internal functions (operational activities) that a firm must excel in to win over investors and/or flourish. In order for a business to prosper, market share must be attracted, according to the consumer perspective. It also has to do with how the business deals with the customers to ensure their high satisfaction. An organization must determine the knowledge, talents, and resources it needs to have or acquire in order to advance (Abofaied, 2017). Since it can be used to gauge business success using both financial and non-financial metrics, the BSC has gained support from supporters. Because of this, the theory is very helpful for measuring performance in organizations with and without a financial foundation. It also provides a four-pronged framework for determining the success and expansion of a business (Kamakoty, 2018). The theory also provides a plan for corporate expansion as well as a way to evaluate the performance and development of organizations (Lawrie & Cobbold, 2004). Utilizing both financial and non-financial variables, the researcher was able to assess the success of the target institutions by applying this theory. Additionally, the theory is suitable for analyzing how portfolio diversification strategy can be implemented to improve organizational performance with a focus on the four perspectives represented in BSC theory because it can provide information on strategy implementation relevant to meet stakeholder interests (Kamakoty, 2018).

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Conceptual Framework

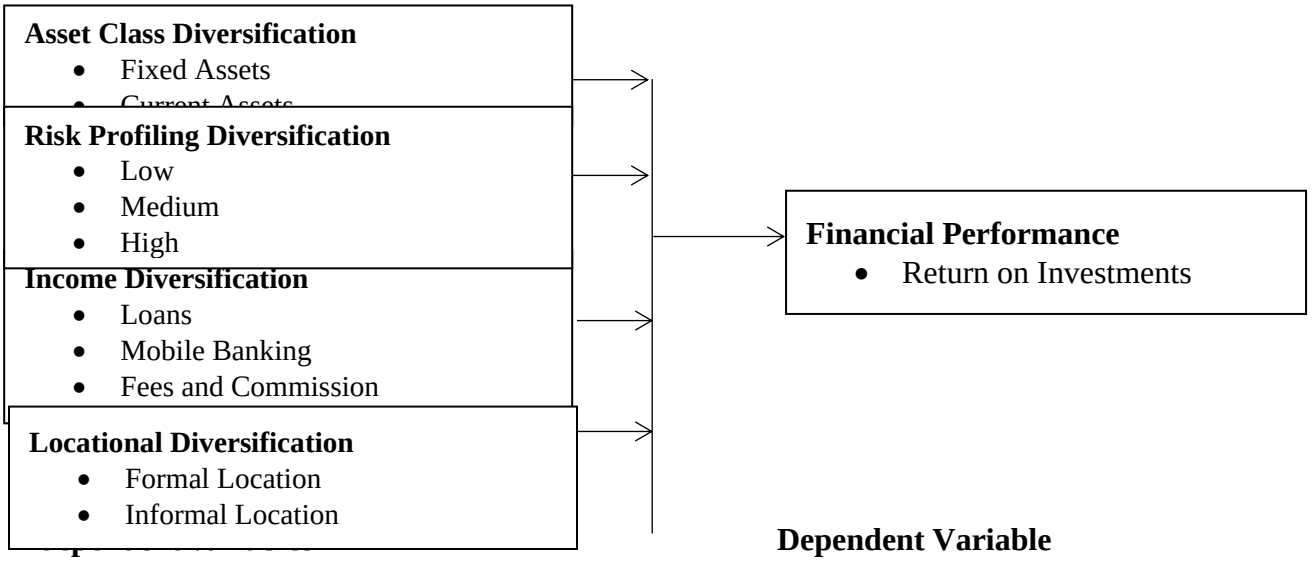

Figure 1: Conceptual Framework

Asset Class Diversification

Asset diversification comprises of a portfolio share that is spread through different classes of markets, regions and assets (Ngware *et al.,* 2020). Asset class diversification as a crucial principle for proper investing and aims at realizing revenues for permitted margin risk through combining different asset classes in a well calculated manner, Muhia (2016). This creates a room for smoothening returns variability realized in each class of asset. Financial institutions' assets majorly comprise of loans, cash, financial assets as well as other premises and assets. Diversification of assets in the financial institutions can be assessed through probing financial assets, loans and similar investments and cash equivalents Wanjiru and Nzulwa (2018). Asset class diversification is a widely adopted and employed strategy with the aim of curbing the operational environment and markets for investors (Muhia, 2016). The major benefit attached to the approach is reducing the volatility of portfolio and losses which is key with increased uncertainties. One of the major advantage attached to any diversification is the fact that it diversifies numerous investments along diversified categories of financial tools where each bears its own risk return magnitude. This type of diversification is executed with key objective being to lower the risk expected that may emanate from having all the institution's assets placed under only one type of investment. Incremental revenues resulting from asset diversification tend to be higher for less capital stocks as compared to other assets. This is due to the fact that small cap stocks possess volatile returns and their associated risks are easily diversified away since they have a lowered correlation with other associated assets. Existent of compelling forces bears the capability of enhancing the probability of coming up with non-significant association between diversification and performance

(Chepkorir, 2018). Due to the fact that there is no perfect indication pertaining to which asset diversification supersedes the other in superiority, the general firms' asset diversification is often perceived as offering superior value to the firm.

Risk Profiling Diversification

Risk profiling as the process of conducting an analysis on exposure to risks and designing the modalities of handling such exposures (Okoth, 2018). The process entails utilization of risk profiling techniques for identifying, assessing and prioritizing risks while at the same time enforcing security. Risk profiling can further be perceived as the systematic application of practices and management procedures which avails to institutions key information necessary for addressing threats that may interfere with the operational efficiencies of a firm. Additionally, risk profiling and management calls for constant review and monitoring aiming at eliminating false negatives and false positive risk assessments (Nyaga, 2014). Throughout the profiling process, there is a dire need for proper communication, documentation, and intensive consultations with key stakeholders. This is due to the fact that that risk profiling is a task for the entire organization as opposed to only a single organization unit. As a diversification process, financial institutions are adopting and implementing risk management and profiling mechanisms in a bid to strengthen their abilities of identifying high risks. Through the mechanisms, risk profiling focus on determining and classifying levels of risks as high, medium or low (Ondu, 2020). Each of the categories of the risk calls for varying attention levels from the management of the institutions. Threats with low risk attributes bears the possibilities of causing minimal loss to the institutions and therefore calls for minimal interventions. Consequently, threats with high risk attributes bears possibilities of causing serious negative effects on performances of the institution thus calls for maximum and thorough examinations.

Income Diversification

Income diversification is increase in growth of new income from earning financial services and products other than the institution's traditional intermediation services (Asmare & Worku, 2018). This makes financial institutions diversify their sources of incomes from traditional interest income in order for them to remain in business for a longer time. Income diversification entails generating or combining incomes from distinctive income generating activities. This generally entails shifting the reliance of incomes from interests sources related with traditional financial intermediation activities to innovative income earning activities that are non-interest. The innovative activities assists the financial institution in diversifying their risks and in performing better financially. Additionally, income diversification plays a role in reducing the distinctive risks which comprise of shocks affecting net margin of interest arising from changes in lending rates.

In recent years, technological innovations and deregulations has paved ways for financial institutions to tap an uprising share of income sources from non-interest oriented sources

(Suleiman, 2020). Through engaging in these sources, financial institutions are in a position of diversifying their sources of income. Driven by changes in structural forces, financial institutions in the emerging markets have experienced a declining trend in the traditional lending activities which has prompted diversification into new ventures. Diversification of sources of income reduces total risk since the process stabilizes the operating income at instances where streams of income imperfectly or negatively correlated (Ouma, 2018).

Locational Diversification

Locational as a process where a firm establishes new markets away from its home market (Sharma & Anand (2019). Locational further refers to diversifying similar business across multiple locations in a country or countries for the sole purpose of generating earnings of the company (Cai *et al.,* 2016). Locational diversification has been perceived to boost shareholders worth through taking advantages of specified assets by accelerating flexibility in functioning and satisfying the preferences of investors holding widened diversified positions. Locational diversification adds value to firms due to extensive resources based on information and related to research and development (Doaei *et al.,* (2014). A firm that diversifies locationally achieves worthiness through attaining operational elasticity thus giving the firm an opportunity of utilizing opportunities in the markets, Njeri(2018). A locally diversified firms bears the capability of shifting activities from one location to the other depending on demand thus lowering operational cost. Consequently, the firms bears the capacity of exploiting various systems of taxation thus reducing its production costs through shifting some losses or profits to areas with favorable taxation system. Despite a firm diversifying locationally, there is possibility of reducing the value attached to the firm, Doaei *et al.,* (2014). This is due to the fact that the diversification can culminate into clumsy cross-subsidization of entities in the business that appear less profitable. Consequently, locationally diversified organizations can experience high cost of coordinating seamless operations due to unevenness on information flow between divisional managers and the organization's headquarters.

Research Methodology

A descriptive research design was used in this study. The target population was all 57 MFIs operating in Nairobi County and registered under Association of Micro Finance Institutions as the accessible population. The unit of observation comprised of employees in top level management including Chief Finance Officers, Operational Managers and Branch Managers of respective firms making a total of 171 respondents. A census approach was employed in the study. The study utilized both primary and secondary data was used in the study. The study used a self-administered semi-structured questionnaire to obtain primary data. Secondary data was gathered from financial statements of the MFIs for the period between 2017 and 2021 using a secondary data collection sheet. The data was analyzed using both descriptive and inferential statistics. Standard deviation, means, and percentages make up descriptive statistics, whereas regression and product moment correlation analysis make up inferential statistics. The descriptive and inferential statistics was

produced using Excel and SPSS version 22. The results of the study was summarized and presented by through tables. A multiple regression model outlined below was employed to assess the relationship between the variables of the study.

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \varepsilon$$

Y represents Financial Performance, B_0 represents Regression Constant or Intercept, $\beta_1, \beta_2, \beta_3$ and β_4 represents the coefficients of independent variables, X_1 represents Asset Class Diversification, X_2 represents Risk Profiling Diversification, X_3 represents Income Diversification, X_4 represents Locational Diversification and ε represents Error Term

Results

A total of 171 questionnaires were distributed to chief finance officers, operational managers, and chief managers of the selected MFIs. 121 questionnaires were completed in full and sent back for evaluation. According to Mugenda & Mugenda (2013), who observed that a response rate of above 70% is suitable for analysis, this corresponded to a response rate of 70.8%, which was deemed adequate and appropriate for analysis. The drop and pick data collection technique was used in the study, which allowed respondents ample time to complete the questionnaires and resulted in a high response rate.

Descriptive Findings and Analysis

The inclusion of descriptive statistics aimed at providing a description of responses derived from the respondents from the responded questionnaires. Both means and standard deviations were utilized to describe the distributions. The researcher first created questionnaires for each variable and requested that respondents rate the statements on a scale of 1 to 5, with 5 denoting Strongly Agree (SA), 4 denoting Agree (A), 3 denoting Neutral (N), 2 denoting Disagree (D), and 1 denoting Strongly Disagree (SD). The researcher then calculated each statement's mean response and standard deviation. The overall level of agreement with all variables was then calculated by averaging the averages and standard deviations.

Asset Class Diversification

The descriptive results on asset class diversification outlined in Table 1 shows that 92(76.1%) of respondents agreed with the statement that the microfinance have diversified assets in form of fixed assets (nean=4.01, std.dev=0.308), 94(76.7%) of respondents agreed with the statement that the microfinance have diversified assets in form of current assets(mean=4.09, std.dev=0.301) and 99(81.8%) of respondents agreed with the statement that the microfinance have diversified assets in form of cash and cash equivalent(mean=4.23, std.dev=0.281). 68(56.2%) of respondents additionally agreed with the statement that adoption of asset class diversification have lowered the levels of portfolio volatility and losses(mean=3.64, std.dev=0.943) while 80(66.1%) of respondents agreed with the statement that the quality level of assets held by the microfinance has

enhanced the levels of performance(mean=3.87, std.dev=0.927). Overall, all respondents agreed with the statements on asset class diversification as shown by average response mean of 3.968 and standard deviation of 0.522. The results implies that assets class diversification significantly contributes to the levels of financial performances amongst the MFIs. The results concurs with Muhia (2016) who noted that asset class diversification as a crucial principle for proper investing and aims at realizing revenues for permitted margin risk through combining different asset classes in a well calculated manner.

Table 1 Descriptive Statistics on Asset Class Diversification

Asset Class Diversification	SD	D	N	A	SA	Mean	Std. Dev
The microfinance have diversified assets in form of fixed assets	4(3.3%)	14(11.6%)	11(9.1%)	40(33.1%)	52(43%)	4.01	0.308
The microfinance have diversified assets in form of current assets		8(6.6%)	19(15.7%)	48(39.7%)	46(38%)	4.09	0.301
The microfinance have diversified assets in form of cash and cash equivalent			22(18.2%)	49(40.5%)	50(41.3%)	4.23	0.281
Adoption of asset class diversification have lowered the levels of portfolio volatility and losses		18(14.9%)	35(29%)	40(33.1%)	28(23.1%)	3.64	0.943
The quality level of assets held by the microfinance has enhanced the levels of performance	2(1.7%)	12(9.9%)	27(22.3%)	39(32.2%)	41(33.9%)	3.87	0.927
Average						**3.968**	**0.522**

Risk Profiling Diversification

The descriptive results on risk profiling diversification outlined in Table 2 shows that 108(89.3%) of respondents agreed with the statement that the micro-finance have established a risk profiling techniques for identifying, assessing and prioritizing risks(mean=4.36, std.dev=0.169), 111(91.7%) of respondents agreed with the statement that the microfinance have classified risks into low, medium and high(mean=4.13, std.dev=0.272) and 93(76.9%) of respondents agreed with the statement that there are mechanisms formulated in the institution to handle the risks (mean=3.99, std.dev=0.577). Consequently, 85(70.2%) of respondents agreed with the statement that diversifying risks enables the institution to foresee losses associated with the risk and

mitigation methods (mean=3.59, std.dev=1.038) while 116(95.9%) of respondents agreed with the statement that there is a periodic review and monitoring of risks profiled and adjusting in respect to the need(mean=4.27, std.dev=0.226). Overall, all respondents agreed with the statement on risk profiling diversification as shown by average response mean of 4.068 and std.dev of 0.4564. This bears the implications that the MFIs institutions involved in the study practices the outlined risk profiling practices in a bid to boost their performance levels. The results tallies with Ondu (2020) who noted that as a diversification process, financial institutions are adopting and implementing risk management and profiling mechanisms in a bid to strengthen their abilities of identifying high risks.

Table 2 Descriptive Statistics on Risk Profiling Diversification

Risk Profiling Diversification	SD	D	N	A	SA	Mean	Std.Dev
The micro-finance have established a risk profiling techniques for identifying, assessing and prioritizing risks		2(1.7%)	11(9.1%)	49(40.4%)	59(48.8%)	4.36	0.169
The microfinance have classified risks into low, medium and high			10(8.3%)	85(70.2%)	26(21.5%)	4.13	0.272
There are mechanisms formulated in the institutions to handle the risks			28(23.1 %)	66(54.5%)	27(22.3%)	3.99	0.577
Diversifying risks enables the institution to foresee losses associated with the risk and mitigation methods	9(7.4%)	3(2.3%)	24(19.8 %)	78(64.5%)	7(5.8%)	3.59	1.038
There is a periodic review and monitoring of risks profiled and adjusting in respect to the need			5(4.1%)	78(64.5%)	38(31.4%)	4.27	0.226
Average						**4.068**	**0.4564**

Income Diversification

The descriptive results on income diversification outlined in Table 3 shows 120(99.2%) of respondents agreed with the statement that the microfinance have diversified sources of income(mean=4.54, std.dev=0.128), 100(82.6%) of respondents agreed with the statement that the microfinance charges on loans and advances(mean=4.36, std.dev=0.252) and 119(98.3%) of respondents agreed with the statement that there are commissions and fees levied on loans and advances(mean=4.59, std.dev=0.177). 121(100%) of respondents remarkably agreed with the statement that the microfinance has employed mobile banking in its operation(mean=3.67, std.dev=0.993), 91(75.2%) of respondents agreed with the statement that the fees levied on mobile banking transactions acts as a source of income to the institution(mean=3.94, std.dev=0.861) and

91(75.2%) of respondents agreed with the statement that the microfinance have established different forms of mobile loans to clients(mean=3.93, std.dev=0.896). On average, all respondents agreed with the statements on income diversification as shown by average response mena of 4.172 and std.dev of 0.551. The results implies that income diversifications forms one of the key component of portfolio diversification that MFIs can adopt to enhance their performance levels. The results are in tandem with Asmare and Worku (2018) who noted that income diversification plays a role in reducing the distinctive risks which comprise of shocks affecting net margin of interest arising from changes in lending rates.

Table 3 Descriptive Statistics on Income Diversification

Income Diversification	SD	D	N	A	SA	Mean	Std.Dev
The microfinance have diversified sources of income			1(1%)	54(44.6%)	66(54.5%)	4.54	0.128
The microfinance charges on loans and advances		8(6.6%)	13(10.7%)	27(22.3%)	73(60.3%)	4.36	0.252
There are commissions and fees levied on loans and advances			2(1.7%)	46(38%)	73(60.3%)	4.59	0.177
The microfinance has employed mobile banking in its operation				73(60.3%)	48(39.7%)	3.67	0.993
The fees levied on mobile banking transactions acts as a source of income to the institution			30(24.8%)	68(56.2%)	23(19%)	3.94	0.861
The microfinance have established different forms of mobile loans to clients		9(7.4%)	21(17.4%)	61(50.4%)	30(24.8%)	3.93	0.896
Average						**4.172**	**0.551**

Locational Diversification

The descriptive results on locational diversification outlined in Table 4 shows 57(47.1%) of respondents agreed with the statement that the microfinance have established different branches within main town(mean=3.61, std.dev=0.913), 95(78.5%) of respondents agreed with the statement that the distribution of the branches widens the firms customer reachability(mean=4.28, std.dev=0.224), 91(75.2%) of respondents agreed with the statement that the institution have attained increased number of customers as a result of having branches in various locations(mean=4.16, std.dev=0.198) and 57(47.1%) of respondents agreed with the statement that the microfinance have achieved operational efficiency as a result of operating from different regions(mean=3.54, std.dev=0.947). 67(55.4%) of respondents were however invariant with the statement that the microfinance have established different branches within town outskirts

(mean=3.36, std.dev=0.921). On average however, all respondents were in agreement with the statements on locational diversification as shown by average response mean of 3.79 and std.dev of 0.6406. The results implies that the MFIs included in the study practice aspects of locational diversification with the aim of enhancing the performance levels. The results agrees with Njeri(2018) who noted that a firm that diversifies locationally achieves worthiness through attaining operational elasticity thus giving the firm an opportunity of utilizing opportunities in the markets.

Table 4 Descriptive Statistics on Locational Diversification

Locational Diversification	SD	D	N	A	SA	Mean	Std.Dev
Our microfinance have established different branches within main town		12(9.9%)	52(43%)	28(23.1%)	29(23%)	3.61	0.913
Our microfinance have established different branches within town outskirts		34(28.1%)	56(46.3%)	20(16.5%)	11(9.1%)	3.36	0.921
The distribution of the branches widens the firms customer reachability			26(21.5%)	35(29%)	60(49.4%)	4.28	0.224
We have attained increased number of customers as a result of having branches in various locations			30(24.8%)	42(34.7%)	49(40.5%)	4.16	0.198
The microfinance have achieved operational efficiency as a result of operating from different regions		12(9.9%)	52(43%)	37(30.6%)	20(16.5%)	3.54	0.947
Average						**3.79**	**0.6406**

Financial Performance of MFIs

The descriptive results on financial performance of MFIs outlined in Table 5 shows that 82(67.7%) of respondents agreed with the statement that they had recorded an increase in the levels of profits(mean=3.76, std.dev=0.813), 84(69.4%) of respondents agreed with the statement that they had recorded an increase in the levels of liquidity(mean=3.91, std.dev=0.649), 86(71.1%) of respondents agreed with the statement that the returns on investment had increased in the institution(mean=3.79, std.dev=0.869), 76(62.8%) of respondents agreed with the statement that the levels of market share have increased(mean=4.00, std.dev=0.564) and 67(55.4%) of respondents agreed with the statement that the microfinance had recorded a decrease in the levels of bad debts(mean=3.59, std.dev=0.928). An average response mean of 3.81 and std.dev of 0.7646 implies that all respondents agreed with the statements on financial performance of MFIs. The results implies that the MFIs included in the study had attained the various aspects of financial performance as a result of adopting various portfolio diversification (Janice, 2019).

Table 5 Descriptive Statistics on Financial Performance

Financial Performance	SD	D	N	A	SA	Mean	Std.Dev
The microfinance have recorded an increase in the levels of profits			39(32.2%)	72(59.5%)	10(8.3%)	3.76	0.813
The microfinance have recorded an increase in the levels of liquidity			37(30.6%)	58(47.9%)	26(21.5%)	3.91	0.649
The returns on investment have increased in the institution		16(13.2%)	19(15.7%)	60(49.6)	26(21.5%)	3.79	0.869
The levels of market share have increased			45(37.2%)	31(25.6%)	45(37.2%)	4	0.564
The microfinance have recorded a decrease in the levels of bad debts			27(22.3%)	27(22.3%)	36(29.8%)	3.89	0.928
Average						**3.81**	**0.7646**

The study further assessed the changes on Return on Investment for the MFIs for the period between 2017 and 2021. The ROI was assessed as a ratio of net income amount against the cost of investment. The results presented in Table 6 shows that the MFIs witnessed a decline in the levels of ROI between 2017 and 2018. This can be attributed to the unfavorable economic environment as a result of the general elections. The results further shows that the levels of ROI recorded an increase from 2018 to 2020 followed by a decline from 2020 to 2021. This was attributed to the unfavorable economic conditions as a result of Covid-19 pandemic.

Table 6 Return on Investment

Year	ROI
2017	2.69
2018	2.45
2019	2.6
2020	2.8
2021	1.86

Correlation Results

The study included a correlation matrix with the aim of assessing existence of correlation between the independent and dependent variables. The results outlined in Table 7 shows that asset class diversification and financial performance of MFIs in Nairobi County bears a positive and significant correlation(r=35.7%, sig=0.000). The results bears the implications that enhancing asset class diversification in the operations of the MFIs leads to enhanced financial performance by 35.7%. The results are in tandem with Muhia (2016) who noted that asset class diversification as a crucial principle for proper investing and aims at realizing revenues for permitted margin risk through combining different asset classes in a well calculated manner. The results further shows

that risk profiling diversification and financial performance of MFIs in Nairobi County bears a positive and significant correlation(r=23.9%, sig=0.006). The results bears the implications that enhancing risk profiling diversification in the operations of the MFIs leads to enhanced financial performance by 23.9%. The results tallies with Ondu (2020) who noted that as a diversification process, financial institutions are adopting and implementing risk management and profiling mechanisms in a bid to strengthen their abilities of identifying high risks.The results also shows that income diversification and financial performance of MFIs in Nairobi County bears a positive and significant correlation(r=57.7%, sig=0.006). The results bears the implications that enhancing income diversification activities in the operations of the MFIs leads to enhanced financial performance by 57.7%. The results are in tandem with Asmare and Worku (2018) who noted that income diversification plays a role in reducing the distinctive risks which comprise of shocks affecting net margin of interest arising from changes in lending rates. The results finally shows that locational diversification and financial performance of MFIs in Nairobi County bears a positive but insignificant correlation(r=9.6%, sig=0.084). The results bears the implications that improving on locational diversification practices in the operations of the MFIs leads to insignificant improvement in the levels financial performance by 9.6%. The results agrees with Njeri(2018) who noted that a firm that diversifies locationally achieves worthiness through attaining operational elasticity thus giving the firm an opportunity of utilizing opportunities in the markets.

Table 7 Correlation Analysis

		Asset Class Diversification	Risk Profiling Diversification	Income Diversification	Locational Diversification	Financial Performance
Asset Class Diversification	Pearson Correlation	1				
	Sig. (2-tailed)					
Risk Profiling Diversification	Pearson Correlation	-0.171	1			
	Sig. (2-tailed)	0.198				
Income Diversification	Pearson Correlation	0.096	0.086*	1		
	Sig. (2-tailed)	0.81	0.102			
Locational Diversification	Pearson Correlation	-0.009	0.074	-0.153**	1	
	Sig. (2-tailed)	0.118	0.102	0.034		
Financial Performance	Pearson Correlation	0.357**	0.239	0.577**	0.096**	1
	Sig. (2-tailed)	0.000	0.006	0.000	0.084	
	N	121	121	121	121	121

Multiple Regression Analysis

Model Summary

The study conducted a multiple regression analysis with the aim of assessing the degree of relationship between the independent and dependent variables. A model summary was utilized to specifically show the degree of relationship between the combined independent variables and the dependent variable and also to show the percentage accounted by the combined independent variables on the dependent variable. The results in Table 8 shows that R-value was 0.709 implying existence of a moderately high relationship between the combined independent variables and the dependent variable. The coefficient of determination represented by R-square value was 0.503 implying that 50.3% of variations in the financial performance levels of MFIs can be accounted by combined independent variables.

Table 8 Model Summary

R	R Square	Adjusted R Square	Std. Error of the Estimate
.709[a]	0.503	0.4216	0.17953

Analysis of Variance

The study included the ANOVA (Analysis of Variance) to assess the statistical significance of the study model in assessing the relationship between the study independent and dependent variables. The results in Table 9 shows that the sig value was 0.014 which is less than 0.05. This bears the implications that the model linking independent and dependent variables was statistically significant thus a good fit for the study.

Table 9 ANOVA (Model Significance)

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	143.219	4	35.8048	18.1189	0.014[b]
	Residual	229.227	116	1.9761		
	Total	372.446	120			

The regression coefficient model was factored in the study to show how the dependent variable changes when one of the independent variable is increased with one unit. The results in Table 10 shows that asset class diversification positively and significantly affects financial performance of MFIs operating in Nairobi County (beta=0.318, sig=0.000<0.05). This bears the implications that increasing asset class diversification with one unit results to 0.318 units increase in the levels of financial performances of the MFIs. The results tallies with Muhia (2016) who established that asset diversification such as financial assets, loans, cash and cash equivalent and other investments increases financial performances of the financial institutions. The results also shows that risk profiling diversification positively and significantly affects financial performance of MFIs operating in Nairobi County (beta=0.288, sig=0.005<0.05). This bears the implications that increasing risk profiling diversification with one unit results to 0.288 units increase in the levels of financial performances of the MFIs. The results are consistent with Okoth (2018) who noted that firms adopting concentric diversification had a higher chance of increasing growth as compared to their counter parts adopting either Conglomerate or Corporate diversification techniques.

The results further shows that income diversification positively and significantly affects financial performance of MFIs operating in Nairobi County (beta=0.498, sig=0.000<0.05). This bears the implications that increasing income diversification with one unit results to 0.498 units increase in the levels of financial performances of the MFIs. The results concurs with Asmare and Worku (2018) who revealed that investment in loan portfolio, financial asset, government security and

insurance bears a statistically significant and a positive relationship with performance of the commercial banks. The results finally shows that locational diversification positively but insignificantly affects financial performance of MFIs operating in Nairobi County (beta=0.103, sig=0.000>0.05). This bears the implications that increasing locational diversification with one unit results to 0.103 units increase in the levels of financial performances of the MFIs. The results tallies with the findings from Sharma and Anand (2019) who established that geographical diversification enhances the levels of efficiencies of the bank through economies of scale but the degree to which risks is reduced through risk diversification was not achievable from the selected financial institutions.

Table 10 Model Coefficients

	Unstandardized Coefficients		Standardized Coefficients		
Predictors	**B**	**Std. Error**	**Beta**	**T**	**Sig.**
(Constant)	0.713	0.11		6.4818	0.000
Asset Class Diversification	0.318	0.149	0.276	2.1342	0.000
Risk Profiling Diversification	0.288	0.219	0.241	1.3150	0.005
Income Diversification	0.498	0.154	0.443	3.2338	0.000
Locational Diversification	0.103	0.118	0.078	0.8729	0.086

The optimal regression model becomes:

Financial Performance of MFIs =0.713 + 0.498(Income Diversification) + 0.318(Asset Class Diversification) + 0.288(Risk Profiling Diversification) + 0.103(Locational Diversification)

From the optimal model, holding all other factors constants, financial performance of the MFIs operating in Nairobi County stands at 0.713. Income diversification has the highest effect on financial performance, followed by asset class diversification, then risk profiling diversification and lastly locational diversification.

Hypothesis Testing

The study employed the results from the regression analysis to either reject or accept the hypothesis formulated in the study. The summary of the hypothesis testing is formulated in Table 11.

Table 11 Hypothesis Testing

Hypothesis	Method and Criteria	Remark
H_{01}: Asset class diversification has no significant effect on financial performance of microfinance institutions in Kenya	Multivariate regression analysis ($p< 0.05$)	Reject **H_{01}**
H_{02}: Risk profiling diversification has no significant effect on financial performance of microfinance institutions in Kenya	Multivariate regression analysis ($p<0.05$)	Reject **H_{02}**
H_{03}: Income diversification has no significant effect on financial performance of microfinance institutions in Kenya	Multivariate regression analysis ($p< 0.05$)	Reject **H_{03}**
H_{04}: Locational diversification has no significant effect on financial performance of microfinance institutions in Kenya	Multivariate regression analysis($p> 0.05$)	Accept **H_{04}**

Conclusion

The results of the study culminated to conclusions that asset class diversification positively and significantly affects financial performance of MFIs operating in Nairobi County, Kenya. Additionally, aspects of asset class diversification such as diversifying assets in form of fixed, current assets and cash and cash equivalent, and diversifying asset class to lower the levels of portfolio volatility and losses further contributes to improved financial performances of the MFIs.

The results of the study also culminated to conclusions that risk profiling diversification positively and significantly affects financial performance of MFIs operating in Nairobi County, Kenya. Additionally, aspects of risk profiling diversification such as establishing a risk profiling techniques for identifying, assessing and prioritizing risks, classifying risks into low, medium and high, putting into place mechanisms to handle the risks, diversifying risks which the institution to foresee losses associated with the risk and mitigation methods and having a periodic review and monitoring of risks profiled and adjusting in respect to the need further contributes to improved financial performances of the MFIs. The results of the study further culminated to conclusions that income diversification positively and significantly affects financial performance of MFIs operating in Nairobi County, Kenya. Additionally, income diversification practices such as diversifying sources of income, charging on loans and advances, incorporating commissions and fees levied on loans and advances, employing mobile banking in the operations and establishing different forms of mobile loans to clients further contributes to improved financial performances of the MFIs. The results of the study finally culminated to conclusions that locational diversification positively but insignificantly affects financial performance of MFIs operating in Nairobi County, Kenya. Additionally, locational diversification practices such as establishing different branches within main town and town outskirts, having a widened distribution of branches for increased customer reachability, and ensuring existence of operational efficiency as a result of operating from different regions further contributes to improved financial performances of the MFIs.

Recommendations for the Study

The study provides recommendations to the management of the MFIs operating in Nairobi County to enhance the levels of asset class diversification since the practice bears a positive and significant effect on financial performance. This can be attained through adoption of asset class diversification practices such as diversifying assets in form of fixed, current assets and cash and cash equivalent, and diversifying asset class to lower the levels of portfolio volatility and losses. The study also provides recommendations to the management of the MFIs operating in Nairobi County to enhance the levels of risk profiling diversification since the practice bears a positive and significant effect on financial performance. This can be attained through adoption of risk profiling diversification practices such as establishing a risk profiling techniques for identifying, assessing and prioritizing risks, classifying risks into low, medium and high, putting into place mechanisms to handle the risks, diversifying risks which the institution to foresee losses associated with the risk and mitigation methods and having a periodic review and monitoring of risks profiled and adjusting in respect to the need. The study further provides recommendations to the management of the MFIs operating in Nairobi County to enhance the levels of income diversification since the practice bears a positive and significant effect on financial performance. This can be attained through adoption of income diversification practices such as diversifying sources of income, charging on loans and advances, incorporating commissions and fees levied on loans and advances, employing mobile banking in the operations and establishing different forms of mobile loans to clients. The study finally provides recommendations to the management of the MFIs operating in Nairobi County to enhance the levels of locational diversification since the practice bears a positive though insignificant effect on financial performance. This can be attained through adoption of locational diversification practices such as establishing different branches within main town and town outskirts, having a widened distribution of branches for increased customer reachability, and ensuring existence of operational efficiency as a result of operating from different regions.

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