Microfinance Reforms and Financial Inclusion in Kenya

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ABSTRACT

Statistics indicate that about 1.7 billion people can't access a savings account and slightly above 200 million small and medium-sized enterprises are deprived access to satisfactory financial solution. Kenya views microfinances as a development instrument for poverty lessening and economic growth through ensuring financial inclusion. It is due to the acceptance of this vital role of Microfinance that Kenya has undertaken strategic microfinance reforms and regulations aimed at promoting financial inclusion through microfinance business. The research's general objective is to examine the effect of microfinance reforms on financial inclusion. Specifically, to determine the influence of microfinance transformation from non-deposit taking into a deposit-taking microfinance institutions on financial inclusion, to examine the association between microfinance board characteristics and public trust, to investigate the effect of microfinance licensing requirements on financial inclusion and to examine the effect of microfinance prudential standards requirements on financial inclusion in Kenya. The research adopted Financial Intermediation Theory and Public Interest Theory of Regulation. This research utilized descriptive research design and the population targeted included all the thirteen Microfinance institutions, which were licensed by the central bank of Kenya as at 2018. The study used purposive sampling to select six microfinance banks. Both descriptive and inferential statistics were done by use of multiple linear regression analysis. The research results indicated that microfinance transformation ($p_{value}=0.001$), board characteristics ($p_{value}=0.042$), licensing requirements ($p_{value}=0.035$) and prudential standards ($p_{value}=0.002$) significantly influenced financial inclusion. Results from regression analysis indicated a strong relationship between microfinance transformation, board characteristics, licensing requirements and prudential standards and financial inclusion. The study concluded that financial inclusion in micro financial institutions increases when there is sound microfinance transformation, board characteristics, legal requirements, and prudential standards. From the findings, the study recommended that micro financial institutions should support institutions reform functions and processes. Further the study recommended that micro financial institutions should recruit adequate and proficient workers and offer satisfactory training as well as certification for professional appreciation on strategies for microfinance reform processes and their influence on the financial inclusion of the micro financial institution. The research recommends that board members should be reliable and open so as to substantially contribute to financial performance.

Key Words: Microfinance, Financial Inclusion, Board Characteristics, Prudential Standards

DOI: 10.35942/ijcfa.v3i1.181

Cite this Article:

Njagi, J., & Njoka, C. (2021). Microfinance Reforms and Financial Inclusion in Kenya. *International Journal of Current Aspects in Finance, Banking and Accounting*, 3(1), 54-72. <https://doi.org/10.35942/ijcfa.v3i1.181>

1.0 Introduction

Around 1.7 billion individuals have can't access bank account and slightly above 200 million; micro, small and medium-sized enterprises (MSME) deprived access to satisfactory financial solution (Demirguc, Klapper, Singer, Ansar & Hess, 2018). These numbers shows the degree

of financial exclusion. Financial inclusion refers effective access to credit facilities, payments, savings as well as insurance services to all adults from formal and regulated service provider (Roa, 2015). According to the World Bank estimates, between 2011 and 2014 the number of account holders globally rose by seven hundred million. Further, in 2014 around sixty two percent of the global adult population were account owners, which was a rise from fifty one percent in 2011. However, according to Demirgüç *et al.*, 2015, approximately two billion grown-ups remain without a bank account. Rao (2015) noted that a proper-functioning financial system is a crucial building block for fiscal growth and prosperity. Fostering an inclusive financial system helps ensure that low-income people will share in the benefits of growth, by being better able to access credit markets, smooth consumption, and plan for the future.

The major challenge in lower income group is lack of access to banking in mainstream banks and other financial services, which becomes an hindrance in their economic and social development (Biju & Joseph, 2016). The main aim of financial inclusion is to ensure monetary facilities are easily accessible and obtainable by low-income earners, hence the role of microfinance. To achieve financial inclusion, it is significant to ensure availability of banking facilities in areas that have no banks as well as offer financial services to every household (Agarwal, 2016). The various Micro Finance Institutions (MFIs) have made it possible by providing small amount of loans to low-income earners without the collateral securities. Thus, MFIs through the different types are useful for the development of low-income earners, thereby indirectly achieving the aim of financial inclusion (Kulb, Hennink, Kiiti & Mutinda, 2016). Inclusive finance ensures provision of monetary services for both persons and MSME. Financial inclusion is defined as making fiscal services accessible to lower income earning families and MSME from microfinance institutions (Chen, Chang & Bruton, 2017). Developing countries require provision to equal access to fiscal services as they boost the efforts to eradicate poverty and achieve economic development (Johnson & Arnold, 2012; Rosengard, 2016).

In Sub-Saharan Africa around two thirds of adults which are three hundred and fifty million adults remain unbanked and especially majority of women are usually not included in the financial system. Few women in developing countries and especially in Africa have an account in relation with men counterpart. This discrepancy in gender is further noted in the majority of third world countries, where 59% and 50% of adult men and women respectively, have existing accounts in financial institutions. Sudan and Senegal representing many developing countries experience worst gender inequality in terms of financial inclusions whereby about half of women are not likely to have an account as compared to about half of men. Though in other African nations for example Ethiopia, Burkina Faso and Ghana, there is equal financial inclusion of men and women, while having an account among women in Mauritania, Mali and Gabon almost have doubled (World Bank, 2014). Poor people still lag behind in terms of having a bank account. In several economies, the number of rich people owning accounts is three or four times higher than poor, including Angola, Zimbabwe and Rwanda. Despite that a vast number of the region's poorest people are left out from the financial system; some economies have experienced fast growth in account ownership among the low income earners, including Zambia, Nigeria, and Botswana (Hurst, Gibbon & Nurse, 2016). Financial stakeholders in finance industry note that there is a critical challenge of insufficient accessibility to financial information, products and services in Kenya for the low income and especially those residing in rural areas. Until the year 2016 twenty five percent of adults in Kenya did not access any kind of financial services (KNBS, 2016).

This is further reinforced by noting the large swathes of the country, particularly in the northern regions, that are largely devoid of financial services access points (KNBS, 2016). A lot of

endeavour has been put to alleviate this challenge that affects the living standards of poor communities and the economic development (Spratt, 2016; Chikweche & Murisa, 2015; Githaka, Kimani & Gachora, 2017; Kariuki, 2016; Kamau & Ngugi, 2014; Roux, 2016). Recent empirical evidence shows that access to main financial facilities can lead to a substantial positive change in alleviating poverty. However, many traditional banks have provided finance to only privileged people with sufficient collateral, since there is a high probability of defaults among the poor people. But Micro finance has been a successful tool in offering small scale financial services to the world's poor traditionally excluded from financial markets. The financial services are mostly loans and savings and increasingly other facilities such as insurance as well as money transfer (Fletschner & Kenney, 2014; Filmer & Fox, 2014; Kenya Financial Sector Deepening, 2015).

1.1 Statement of the Problem

Microfinance in Kenya has been viewed as a development device for lessening poverty as well as enhancing country's economic development by ensuring financial services accessibility to all. Despite Kenyan government having undertaken several reforms in this sector to ensure that MFIs make financial services accessible to low-income households, statistics show that at least 25% of Kenya's adults lack access to any form of recognized financial facilities provider and more than fifty percent of this population falls in Micro and Small Enterprises (MSEs) and low-income families (Fin Access Household Survey, 2016). The 2016 legislation on microfinance, legislation on amendment Act, 2013 and legislation on microfinance regulations, 2008 were legislated to help Micro Financial Institutions supply financial services at reasonable costs to low-income households group and MSEs. These Reforms were also to provide a regulation and supervision framework to guarantee that Micro Financial Institutions follow the set requirements of financial sector safety (Republic of Kenya, 2008; Smith, 2015), in 2006.

In microfinance there are various supply challenges which include cost of getting financial services, the bank minimum balance requirements, ledger fee costs and physical challenges emanating from long distances between people's homestead and financial institutions' branches, thus creating barrier to financial services access (Hsia, 2015). Further, the lack of tangible collateral security, provision of unsuitable products for clients with low, uneven income, alleged high risk, insufficient information, increased costs as well as premiums placed on the poor people and low income borrowers by financial institutions (Hurst, Gibbon & Nurse, 2016). In microfinance the Demand-side barriers include; lack of income, inadequate incomes and non-continuous income flows or employment; lower education level and insufficient financial knowledge; and religious plus socio-cultural barriers (Iqbal & Mirakhor, 2011). Due to these hurdles, it was significant to reform the micro finance sector to satisfactorily meet the Kenyan citizenry's needs (Hannig & Jansen, 2010). Among the ways of promoting financial inclusion was catalysing the growth of innovative, less multifaceted and cost effective financial tools by policy reforms as well as initiatives so as to efficiently serve the excluded and underserved parts of the population (Ismail, Zaenal & Taufiq, 2016).

For Kenya to attain the three pillars of Vision 2030 which are economic, social and political and ensure the attainment of the 17 Sustainable Development Goals (SDGs) and break out of the vicious cycle of poverty, a savings culture especially among the poor households and SMEs, Microfinance business must be encouraged because this is the role it plays. This is true because many traditional banks are inclined to providing finance to privileged people with sufficient collateral as they view low-income households and SMEs as being too risky to lend to (Njuguna, 2015). A country cannot eradicate poverty and promote economic development when a large population has insufficient access to financial service. This led to Kenyan government coming up with various financial sector reforms with the aim of ensuring a strong

and steady financial system, which is critical to economic growth and eradication. Thus, this research examined microfinance reforms' effect on the financial inclusion in Kenya.

2.0 Literature Review

2.1 Theoretical Literature Review

This section discusses theories which inform the study and these theories include financial intermediary theory and public interest theory of regulation.

2.1.1 Financial Intermediation Theory

Gurley and Shaw first advanced the Financial Intermediation theory. The role of financial intermediation theory is to determine how financial intermediaries function and the reason of their existence. It forms basis on the idea that mediators assist to reduce transaction costs and informational asymmetries. The savings or process of investing in capital markets is done in relation to financial intermediary, creating them as central institutions of economic development. According to Rose (2012) financial intermediary is an organization that loans money from customers or consumer and lend to entities that require financial resources for investment. The theory focuses on functional activities of financial mediators, for example reducing the costs of transaction, providing liquidity, information and renegotiation debts. Philippon (2015) argues that it analyses how financial intermediary affects the economic growth generally and the government policies impacts on the financial intermediary

The financial intermediary theory explains the function of financial mediation in economic development; research studies reviewed indicated that the role of financial intermediary theory is help the government meet sustainable economic development, and the effect of legislations on financial intermediary, putting emphasis on the function of the Central Bank in the controlling, supervising and managing the financial intermediates. Financial intermediates transfer money from groups with a lot of capital to groups that require money (Hannig & Jansen, 2010). This process aids in ensuring efficient markets and brings down the cost of operating business. The theory is crucial in this study as it expounds on the importance of the microfinance reforms overseen by CBK. As explained above, the theory pays much focus on bringing sustainable economic development and in this context one of its parameter is financial inclusion.

2.1.2 Public Interest Theory of Regulation

This is an economic theory, which was first coined by Arthur Cecil Pigou. There are three basic assumptions guiding this theory, which include the common failures in the market, a tolerant regulator or organized political procedures and choosing of effective regulatory body. Gaps amid attitudes and cost of materials or resources can be as a result of flawed competition, market instability, and lack of markets or unwanted market results. Flawed competition can lead to deviation of prices from marginal material cost. Unstable markets instability is seen by continuous inefficiencies in relation to markets stability. Market instabilities cause wastage in limited resources. Lack of markets means that the there is demand for critical goods and services in which the sum value is more that the total cost but where the market costs cannot rise. Though competitive market strategy divides limited resources well, the results of the market procedures can still be seen as not desirable from other social perceptions (Carpenter & Moss, 2013). Describing these market limitations with assumption that initially the government acted as an institution that knows everything powerful and helpful regulator.

The group of regulatory theories were based on the suppositions of total information, flawless implementation and helpful regulators. They explain that the controlling of organizations or other key economic players who help in enhancing the public interest, which is defined as the

better way of dividing limited resources (goods and services) for individual as well as all people in the society. In developed nations, the division of limited resources is greatly controlled by the forces of market strategy. Theoretically, it can be noted that, in certain situations, the division of limited resources by way of the market strategy is most appropriate (Smyth & Söderberg, 2010). Due to the fact that these circumstances cannot be usually applied practically, theoretically the division of limited resources has no importance and a search for ways of enhancing the limited resource division appears (Mizutani & Nakamura, 2015).

Failure of the market implies that limited resources are not used highest optimally. The cost of products and services shows these values in a market setting. Failure of the market hence means a gap amid the cost of a more unit of a given product or service and its important price. Usually in a market or trade, the production by an organization should increase until an important marginal product price of a more unit is the same as its critical marginal benefit. Ensuring that prices and marginal prices are equal indicates competitive trade equilibrium. In instances where costs are less than the calculated market costs an organization will benefit from increase in production. When the cost are more than price an organization will raise its benefits by restricting production awaiting cost to be the same as the marginal price. Market equalization and more general market equalization in all markets is hence condition of an ideal division of limited resources. In such circumstance supply is equal to demand and in such a situation market actors can't do any better. For a competitive market economy to be in existence, many conditions have to be met for an optimal division (Carrigan & Coglianese, 2016).

Among the approaches of ensuring effectiveness in the division of limited resources after experiencing market fiasco is to have government control (Carrigan & Coglianese, 2016). During the initial creation regulation theories related to public interest, it was asserted that a failure of market was enough state to describe federal control (Battiston, Farmer, Flache, Garlaschelli, Haldane, Heesterbeek & Scheffer, 2016). Later the theory received criticism for its Hinduism and Buddhism approach, meaning that it ascertained that in theory effective organizations can be thought to effectively replace ineffective world institutions (Marti & Scherer, 2016). The disapproval of development theory led to the creation of risky public interest model of control through what has been unanimously known to be new harbour or advanced school of law as well as economics.

The cost of transaction and information of regulation in the initial theory were asserted to be zero. By assessing the above costs, additional complete theories of public interest were coined. It can be noted that the administration control is relatively the most effective organization to sort out numerous market downfall (Carpenter & Moss, 2013). For instance, for the public resources it can be cited that the government control operation outlays to create reasonable costs and a reasonable return rate are less than the prices of stiff rivalry (MacNeil & O'Brien, 2010). Equally, it can be asserted that societal control in certain circumstances could be a great effective establishment to compact the environmental contamination or compacting with workplace accidents as compared to private consultations between affected groups. The government regulations would be affected by the information market failures and they can greatly as well as easily package information to determine the point where the peripheral cost of intercession equals the minimal social proceeds (Carpenter & Moss, 2013). These additional tough types of theories of public interest fail to accept that control is impeccable. However, they accept the existence of failures in the market that by-law is reasonably the added effective institution as well as that for instance decontrolling is carried out when great effective institutions improve. These philosophies also accept that legislators work in consideration of the public interest or governmental process is effective and prices and profits of bylaw information is extensively disseminated and accessible (Baldwin, Cave & Lodge, 2012).

2.2 Empirical Review

Global Index survey of 2014 identified poverty and distance from the financial institution and their homes as the main barriers to financial access. Globally, 59% mentioned poverty as a reason for owning a bank account, although only 16% mentioned it as the main reason. Poverty is a significant factor in Sub-Saharan Africa, mentioned by 72% as one cause and 28% as the only one. Twenty-seven percent of adults without bank accounts said the distance between financial institutions and their homes was one of the reasons they failed to sign up. However, the percentage linking distance as the only reason was minimal (World Bank, 2015; Demirguc *et al.*, 2015).

Demirgüç-Kunt and Klapper (2012) surveyed characteristics of financial systems around the world (205 economies) from 1960 to 2010. The characteristics included; financial market and institution size (financial depth), extent to which individuals' access financial services, financial markets and intermediaries' efficiency in intermediating resources and enabling financial transactions, and financial markets and institutions stability. The study illustrated that financial sectors are presented in various shapes and sizes, and vary widely in regards to their performance. This is consistent with Gatnar (2013) who studied Poland's financial inclusion. The indicators of financial inclusion were calculated using the data gathered and analysed by the payment system as well as statistics of the National Bank of Poland. Based on the above financial inclusion measurement, the study found that only twenty three percent of Poles did not have a bank account.

Many countries have tried to solve the problem of financial inclusion. For instance, south Africa developed the Mzansi account according to south Africa Financial Sector Chatter commitments, whose legal framework was retrieved from the Broad-based Black Economic Empowerment (BBBEE) Act. It recommended banks to increase accessibility to the country and, specifically, to rise banking availability to all communities. As a result, the proportion of South African adults in banking rose from 46% to 63% between 2004 and 2008 (Sood & Mukherjee, 2016). Abu Seman (2016) investigated the role of financial system on financial inclusion with precise reference to Islamic finance with guidance of Institutional theory. The results showed a positive Islamic finance impact in shaping financial inclusion. The impact was greater in Islamic countries like Indonesia and Malaysia than in non-Islamic countries. These results were consistent with many other studies that have investigated Islamic Finance and Financial Inclusion in many nations (Naceur, Barajas & Massara, 2015; Ismail, Zaenal & Taufiq, 2016; Shaikh, Ismail, Shafiai, Ismail & Shahimi, 2017).

According to statistics by KNBS, until the year 2016, 25% Kenya's adults still are unable to access financial services. This is further reinforced by noting the large swathes of the country, particularly in the northern regions, that are largely devoid of financial services access points (KNBS, 2016). Significant determinations have been prepared to report this challenge that influences straight on the living standards of needy people and economic development (Spratt, 2016; Chikweche & Murisa, 2015; Githaka, Kimani & Gachora, 2017; Kariuki, 2016; Kamau & Ngugi, 2014; Roux, 2016). A quantitative study by Kenya Financial Sector Deepening (2015) indicated that access to basic financial services can lead to a considerable positive variance in bettering poor people's lives. The study further noted that many outdated banks continue to offer finance to only privileged people with sufficient collateral citing a higher risk of default among the low income people. To close this gap, Fletschner and Kenney (2014) observed that Micro finance has been a successful tool in offering small scale financial services to the world's poor traditionally excluded from financial markets. The financial services are majorly loans and savings as well as increasingly other developing products such as money transfer and insurance. It is such findings that informed the Kenyan government to enact

microfinance reforms in order to promote financial inclusion through microfinance. However, there is lack in empirical literature on how these reforms have affected financial inclusion in Kenya. It is one of the gaps the study will endeavour to fill.

Siwale and Okoye (2017) studied the influence of rules on Nigeria and Zambia's microfinance organizations. The research concentrated on post rule practices and considerations of MFIs and their supervisory body. Data was collected using in interview schedule with the Central Banks as supervisors, microfinance organizations directors, experts and top microfinance relationship. The outcomes revealed that procedures in both nations had achieved to have professional zones, but their efficiency in growing the significance of public objectives to microfinance and microfinance organizations rests to be uncertain. The study further found that the poorly developed rules not only did they challenge communal objectives but also sent incorrect signs to would be communal stakeholders, with consequences for the societal appearance of the business. Furthermore, the study discovered that rules have neither fastened the development of viable microfinance organizations (particularly in Zambia) nor fast-tracked the segments' outreach to the deprived and the economically omitted.

Kenyuru (2013) studied the relationship between Kenya's microfinance banking and financial inclusion. The survey was anchored on Social capital, Financial Intermediation and the Modern Development theories. It included all registered Microfinance Institutions. Results showed that the availability of micro banking services and a resilient branch network were the major factors that promoted financial inclusion in Kenya. A study by Magutu, Khoya and Onsongo (2010) on the factors influencing microfinance transformation from Non-Microfinance Bank Business to Microfinance Bank Business in Kenya noted that the factors included increased customer base and improved quality of service. The findings also identified stringent guidelines from the Central Bank; high operation costs; unscrupulous microfinance institutions spoiling the reputation of the industry as the challenges facing microfinance transformation. These findings were similar to Ndulu (2010) who identified capability to achieve capital requirements, capability to raise resources for microfinance transformation, reorganizing current ownership as well as acquiring new shareholders, getting favourable information systems, incentive to be regulated, governance concerns and managerial apathy as factors explaining why some institutions have moved quicker than others in the alteration process as well as why others have opted to stick to credit alone.

According to Artero (2007), corporate governance refers to "the system by which firms are controlled and directed, which is evidently the obligation of their boards of directors". It is about developing credibility, guaranteeing accountability and transparency as well as sustaining an effective flow of information disclosure which would facilitate good corporate performance. Chan, Watson and Woodcliff (2014) noted that disclosure and trust are the integral pillars of a sound corporate governance system. It involves how to develop trust and maintain confidence amongst the different interest groups that form an organisation. In another study, the influence of business sustainability on managerial procedures and productivity was investigated (Eccles, Ioannou & Serafeim, 2014). The research used a sample of 180 US firms. The outcomes of the study indicated that businesses that willingly accept sustainability rules by 1993 dubbed as great sustainability firms reveal by 2009, distinct administrative procedures associated to a matched model of organizations that implemented none of procedures, termed as Low Sustainability firms. The findings also revealed that the panels of executives of these corporations were officially accountable for sustainability and topmost management reimbursement motivations were probably a purpose of sustainability measures. Furthermore, great sustainability businesses were further expected to possess developed procedures for interested party commitment, to be more continuing and to show higher amount and revelation of nonfinancial data. From the facts produced, the study established that great sustainability

corporations considerably outdo their equivalents over the long-lasting, equally in regards to stock marketplace as well as bookkeeping productivity.

A study by Rogers (2006) to establish the connection amid the core ideologies of corporate governance and financial performance Uganda's commercial banks showed that Corporate Governance forecasts 34.5 % of the difference in the broad financial performance of the banks in that country. The substantial contributors to financial performance entail reliability and openness. They were employed as measures of trust whereas credit risk was utilized as a portion of disclosure had an undesirable association with financial performance. The study gave recommendation that both local and international bank should implement full corporate governance in order to remain competitive. According to the Microfinance (Deposit- Taking Microfinance Institutions) Regulations, 2008 each organization will be managed by a board, which two-third of its members are nonexecutives. The board will also include an Audit committee and Credit committee. Moreover, the board will convene at least once quarterly, to discuss on the concerns and financial state of the organization and offer oversight and supervision to the management. Board members are required to attend not less than 2/3 of the planned board meetings in any financial year (Microfinance Regulations, 2008).

A study by Onger (2011) on financial performance and the level of implementation of corporate governance practices by SME in Kenya measured corporate governors using indicators such as financial transparency, trust and disclosure. The findings of the study showed association among business governance processes and viability of the businesses. The procedures examined comprised: board of management availability; presence of a structure of assessing panel and specific executives; presence of regulations to rule board seminars; as well as usage of aggregate voting for elections of executives. The outcomes also revealed that use of the subsequent business governance processes had a direct effect on viability of the businesses that contributed in the research: allotting 4 or more consistent panel summits each year; stakeholder's choice of date or place to inspire attending; and panel endorsement requisites for associated party dealings. Kamonjo (2014) surveyed the influence of business authority measures on economic performance of Kirinyaga County SACCOs. The independent concepts included size of the board, internal assessment purpose and regularity of seminars of the board. Utilization of Return on Capital as a quantity of fiscal performance. Population was from 13 urban active SACCOs found in the County of Kirinyaga and the study utilized a complete census of the population. The study findings showed a negative connotation among the panel's size and the financial performance; the typical panel size of 7. The findings also shown a positive association among the frequency of panel summits each year and ROCE; each year had the normal number of consultations as 10 ten. Concerning the existence of internal inspection role, the study showed an undesirable connection among ROCE and the existence of the audit internal role plus only 23.7% of the sample affirming existence of audit departments in their SACCOs.

Microfinance licensing is imperative to ensure that there is uniformity on operations of these institutions as well as ensure the financial regulations are followed. Moreover, the licensing requirements pave a way for the achievement of financial inclusion of any state. A study by Aggarwal and Klapper (2013) examined policies designed by various governments to foster financial inclusion across the world. The study reviewed barriers to financial inclusion and regulatory policies introduced to remove them. Some of the barriers that were highlighted by this study were physical, inflexible, fiscal and dependence obstacles to the use of official records. The administration of India in 2006 developed a knowledge driven financial transactions correspondent framework for the overview of "No Frill Accounts" (NFA's) as well as the spreading out of branchless investment to areas not served by any official financial organization. They stimulated a list of options of delivery expertise, with simulations stretching

from kiosk simulations, to portable based biometric simulations, to SMS based mobile framework (Akhtar & Pearce, 2010). However, there was extensive disapproval that CSP's have not provided the envisioned outcome as demonstrated by potential tariffs on No Frill Accounts projected at eighty eight to ninety six percent. An obstacle is the profit-making feasibility of the "None Frill Books at the financial level; they were very small to appeal business attention or incomes.

Myers, Cato and Jones (2012) conducted a study in Brazil to assess the government's function in promoting financial inclusion among the poor. The study noted Brazil's Bolsa Familia program in which the government supplies cash allocations to twelve million beneficiaries had increased bank penetration among the rural poor. This programme is card-based and enabled the recipients to access their deposits using bank automated teller machine systems or the post office. Though, generally, these cards do not offer all facilities of a bank account like payments and investments. An examination on the causes of financial exclusion in Nigeria by Onaolapo and Odetayo, (2012) identified the main ones to be bank needed several identification documents, the stringent terms and conditions of bank on owning accounts, bank charges levels, and cultural and physical access obstacles in financial inclusion. These findings were similar to Triki and Faye (2013) who agreed that the areas with no banks in the whole of Africa remain so as a result of geographical inaccessibility, inadequate infrastructure; the high banking services cost and insufficient financial understanding. The study results further showed that the Microfinance policy in Nigeria had positively contributed financial facilities to those without the catchments of the big banks either due to their earnings, location, education level or discrimination.

A study by Ali (2015) on Supervision and Regulatory Framework of Kenya's microfinance on noted that to stimulate microfinance efficiently and uphold its sustainability, a suitable regulatory system should be put in place. This is in line with Mohieldin, Iqbal, Rostom and Fu (2011), who studied the role of Islamic finance in improving financial inclusion in Organization of Islamic Cooperation (OIC) nations. Their results depicted that microfinance firms can enter the field of a permitted and prudentially managed financial intermediation. Moreover, regulations should be developed to permits the effective and efficient growth of the MFIs.

Prudential standard is a regulation that needs financial institution to ease against risk and hold enough capital as needed by capital requirements thus acting as a consumer protection. Capital adequacy ratio is the measure most extensively depended on by watchdogs to monitor bank creditworthiness (Ng & Roychowdhury, 2014). Its requirements are founded on the foundation that capital works as a block against probable depositors and creditors losses. Similarly, there should be provisions for loan loss so as to form reserves to take care of future losses (Leventis, Dimitropoulos & Anandarajan, 2011). According to Biljanovska (2016), capital adequacy of the financial institution's capital position, from a regulatory and economic capital perspective, as suitable to the organization. The assessment of capital sufficiency ought to consider the risk intrinsic in firms' activities and the capital ability to absorb unexpected losses, to offer a base for growth, as well as to maintain the composition and level of the parent entity and subsidiaries' debt.

A quantitative study by Steel and Andah (2003) on Implications of Micro Finance Regulation for Development in rural setup and Performance of Industry in Ghana observed that reforms and guidelines governing Rural and Micro Finance Institutions (RMFIs) in Ghana had advanced with the market, both creating opportunities for new forms of institutions and constriction to prevent excessive entry as well as fragile performance in instances of insufficient supervision capability. The study further observed that the regulations had resulted

into improved capital adequacy through subsidized loans under government poverty reduction programme.

Bi and Pandey (2011) compared the microfinance organizations performance with Indian commercial banks. The study selected a sample from India's MFIs with reference to their ratings given by Microfinance Information Exchange where MFIs have conveyed their financial data. Under financial structure, the study examined Capital Adequacy Ratio. The results showed that India banks are required to uphold a Capital Adequacy Ratio of 9% and MFIs had in surplus of 20% and 25%. This was similar to Zegeye (2015) who noted in his study on performance of MFIs in South Africa that a greater is significant for the MFIs since a thin layer of capital do not give room for loss absorption in instances of default. Shankar and Asher (2010) examined the need for regulating microfinance and noted that there is need to respond to regulatory concerns to allow the microfinance industry to actively take role to achieving financial inclusion, as well as to offer an environment that all investors can take part with self-confidence. The study further observed that CAR was often used as a rationing tool so as to maintain the number of MFIs to be overseen within manageable limits. Similarly, Adams (2017) agreed that capital adequacy requirements are founded on the foundation that capital works as a block against probable depositors and creditors losses hence there should be loan forfeiture provisions hence building reserves for future losses.

In the Kenyan context, Wambugu and Ngugi (2012) investigated the aspects affecting management of microfinance organizations in Kenya in the context of Kenya Women Finance Trust (KWFT). The study focused on the effect of aspects such as capital adequacy, branch network, Service delivery and staff training. It involved low-level and top management in KWFT saving receiving microfinance. A 30% sample size was chosen via stratified random selection. The study also aimed to find out the influence of capital sufficiency on sustainability of small financial enterprises organizations in Kenya. Research findings revealed that majority forty six percent agreed that KWFT had enough capital to cater for non-payment in the loan portfolio, 42% agreed the microfinance had sufficient capital base that played a role in lending practices and had an improved outreach due to satisfactory capital respectively. Moreover, the research results showed that 50% of respondents, affirm that ample capital affected the KWFT customers' attitude and compact part market dissection. Moreover, study findings showed that 42% of respondents agreed that enough capital provided KWFT authority to allocate resources for the awareness of sensible rules, which stimulated the need to provide more financial services such as letting them to voluntarily make deposits. Additionally, findings indicated that majority of the respondents (50%) indicated that capital sufficiency affected sustainability of Kenya women finance trust to a great extent, 33% specified to a great degree, 13% showed to an average degree while a little 4% portrayed that capital sufficiency affected sustainability of Kenya women finance trust to a very small extent.

2.3 Conceptual Framework

The conceptual framework presents the response and predictor variables on the microfinance reforms and financial inclusion in Kenya. The conceptual framework in figure 1 illustrates the association between predictor and response variables. The predictor variables are microfinance transformation, board characteristics, licensing requirements, and prudential standards. The independent variables are microfinance transformation, board characteristics, licensing requirements, and prudential standards.

Independent Variables

Dependent Variable

MICROFINANCE REFORMS

Figure 1 - Conceptual Framework

3.0 Research Methods

This research study employed descriptive and explanatory designs to achieve the results. According to Yin (2017), descriptive research refers to a study designed to portray the respondents in a precise way. According to Larsen-Freeman and Long (2014), a descriptive research design entails obtaining whole data that is contextual in nature and with detailed information for answering research questions or testing hypotheses about the current state of the subject under the study. While explanatory research design entails the modelling of a cause-effect association between the predictor and the response variables and describe the degree and direction of the association (Mugenda & Mugenda, 2003).

The research focused on thirteen (13) selected microfinance banks licensed and regulated by the CBK as at 2019. The research study employed purposive sampling to identify respondents from the two microfinance departments which are operations and business development. Employees in these two departments are more involved with customer relations hence are well

informed with issues relating microfinance reforms and financial inclusion. In this study, primary data used structured questionnaires. The instrument were taken to the respondents in the microfinance banks using self-administered technique. The researcher engaged four assistants to hand deliver the instrument to the respondents and ensured that they collected them from the respondents after two weeks. Multiple linear regressions were utilized to assess the collective influence of the predictor variables on the response variable.

4.0 Data Analysis Results

The table below shows the model summary from the regression analysis.

Table 1- Regression Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.915	.844	.817	.71304

Source: Research Data (2021)

This analysis will help to comprehend, which among the independent variables are relating to the dependent variable, and to identify the forms of these relationships. Adjusted R squared increases only if the new term improves the model more than would be expected by chance. It decreases when a predictor improves the model by less than expected by chance. From the results above, the adjusted R squared is 0.817, implying that the independent variable chosen in order to determine the dependent variable is able to explain the variation in the dependent variable.

Table 2- ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	2.1311	8	0.351	3.021	.034
	Residual	26.275	74	0.328		
	Total	30.325	92			

Source: Research Data (2021)

We reject H_0 because $0.034 < 0.05$. We have statistically significant evidence at a $\alpha=0.05$ to show that there is a difference in mean composite effect of the four constructs (Microfinance transformation, board characteristics, licensing requirements and prudential standards) on financial inclusion. The regression result explored the essential indicators of financial inclusion by utilizing the variables indicated in the model. The suitable indicators of the variable used to ascertain the financial inclusion are explored. This means that, the value of R square employed to indicate the variation in the dependent variable (financial inclusion) is indicated by the model. The larger the value of R square the better the model is.

The general influence of Microfinance transformation, board characteristics, licensing requirements and prudential standards accounted for 84% ($R^2=0.844$) of the variation in the financial inclusion, the rest 16% are other variables not included in this study.

Table 3- Regression Results

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.260	.261		.8830	.000
	Microfinance Transformation	.033	.106	.316	3.165	.001
	Board Characteristics	.015	.142	.061	1.610	.042
	Licensing Requirements	.020	.105	.206	1.733	.035
	Prudential Standards	.017	.064	.157	1.304	.002

Source: Research (2021)

The empirical model from the linear regression that accessed the collective effects of all the independent variables on the dependent variable is as represented below;

$$Y=0.260+0.033X_1+0.015X_2+0.020X_3+0.017X_4$$

Where; Y = Financial inclusion in Kenya (Dependent Variable), X_1 = Microfinance Transformation, X_2 = Board Characteristics, X_3 = Licensing Requirements, X_4 = Prudential Standards. From the regression results, holding Microfinance transformation, board characteristics, licensing requirements and prudential standards constant one at a time, financial inclusion is at 0.260, meaning that an increase in Microfinance transformation would lead to increase in financial inclusion by a factor of 0.033, an increase in board characteristics would lead to increase in financial inclusion by a factor of 0.015, an increase in licensing requirements would lead to increase in financial inclusion by a factor of 0.020 and an increase in prudential standards would lead to increase in financial inclusion by a factor of 0.017. The findings are in tandem with majority of prior identified studies (Myers, Cato & Jones, 2012; Akhtar & Pearce, 2010; Adams, 2017). All the p-values for all the variable are less than 0.05, which indicates that Microfinance transformation, board characteristics, licensing requirements and prudential standards are statistically significant in influencing financial inclusion. The variable's level of significance below 0.05, makes a significance exceptional input to the anticipated value of the dependent variable. Past this level of significance, the variables make no significant contribution in the estimation of the dependent variable (Aggarwal & Klapper, 2013).

5.0 Conclusions and Recommendations

5.1 Conclusions

The study concluded that with the vital and pivotal responsibility of financial inclusion for all, microfinance reforms is the single most mechanism for guaranteeing market share and profitability. The presence of effective microfinance reforms associated with financial market and institution size, extent to which individuals' access financial services, financial markets and intermediaries' efficiency in intermediating resources, enabling financial transactions, financial markets and institutions stability. This lowers inequality in information when making decisions and safeguards the overall performance of the microfinance institutions. The research inferred that financial inclusion in micro financial institutions increases when there are sound Microfinance transformation, board characteristics, legal requirements and prudential standards. The regression modelling show very strong contributions of the variables for the financial inclusion. Further, the relationship analysis indicated all the predictor variables to be

having the direct effect on financial inclusion. Thus, the research concludes that all the predictors were statistically significant at 5% significance level.

5.2 Recommendations

The study recommended that Microfinance transformation from non-deposit taking into a deposit-taking microfinance institution was the critical determinant of the financial inclusion. The study recommended that reliability and openness of the board members contributes to financial inclusion which leads to substantial contribution to financial performance. The study recommended that banks need several identification documents, the stringent terms and conditions on owning accounts, bank charges levels, cultural and physical access for better financial inclusion.

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