FINANCING STRUCTURE AND LIQUIDITY POSITION OF MICROFINANCE BANKS IN KENYA

*Irene N. Ndanu[1] & Dr. Ambrose O. Jagongo[2]

[1]PhD fellow, Department of Accounting & Finance, School of Business, Economics & Tourism, Kenyatta University
[2]Senior lecturer, Department of Accounting & Finance, School of Business, Economics & Tourism, Kenyatta University
Corresponding Author Email: ngui.irenendanu@gmail.com

ABSTRACT

Microfinance banks' liquidity positions have been erratic and unstable over time. Between 2012 and 2017, the overall liquidity trends of Kenyan MFBs fluctuated between a low of 25% and a high of 36%, with some individual microfinance banks registering liquidity ratios below the regulatory threshold of 20%, indicating instability. This study aimed to investigate the effect of financing structure on the liquidity position of microfinance banks (MFBs) in Kenya. Specifically, it sought to determine how customer deposits and equity financing influence the liquidity position of these banks. The study was anchored in agency theory, pecking order theory, trade-off theory, and liquidity preference theory. An explanatory research design within the positivist philosophy framework was adopted. The target population comprised the 13 MFBs registered with the Central Bank of Kenya (CBK), utilizing panel data from publicly available audited financial statements. Data analysis was conducted using panel regression, Pearson correlation, and descriptive statistics, and the results were presented in tables and figures. Hypotheses were tested at a significance level of 0.05, and ethical guidelines were followed throughout. The study found that customer deposits and equity financing had positive and significant effects on the liquidity position of MFBs. Based on these findings, the study recommends policy measures that encourage MFBs to increase their reliance on equity financing by promoting access to diversified equity sources and offering incentives like tax breaks. Additionally, promoting innovation in savings products and implementing educational campaigns can enhance customer deposit mobilization. These policy recommendations aim to foster a more stable liquidity environment for microfinance banks in Kenya.

Keywords: *Equity financing, customer deposits, Liquidity position & Financing Structure*

1.0 INTRODUCTION

1.1 Background of the Study

Microfinance Banks (MFBs) were introduced by the Microfinance Act of Kenya, 2006. Liquidity refers to a financial institution's ability to guarantee that there is always money accessible to pay financial responsibilities reasonable costs (Achieng, Muturi, & Wanjare, 2018). The banks can manage time risk and loan risk as a result. The lending risk was described by Amondi (2020) as a

bank's ability to meet money requests from well-known customers. On the other side, time risk is described as the ability of the bank to make up for a customer's defaulted receipts. For this reason, the CBK is required by law to promote the solvency, liquidity, and effective operation of a financial system that is based on open markets (CBK 2018). This is accomplished by developing regulations that control financial institutions such as microfinance banks (MFBs).

A business's capability to satisfy its financial obligations within one year by turning its short-term assets into cash without suffering any losses is known as liquidity. By paying its debts when they are due, a highly liquid company has the advantage of being able to fulfill its obligations in both the short and long-term run. Only when a firm can lower the liquidity risks connected with the conversion of a liquid asset into cash is liquidity conceivable (Mohamud, 2019). Long-term, Short-term, and overall proportions of debt are used, liquidity is a crucial financial pointer that dictates that a firm can meet its debt obligations without suffering unintended losses (Ali & Faisal, 2020). Utilizing debt increases the likelihood of bankruptcy, thus businesses with higher leverage are anticipated to maintain more cash to lower the likelihood of going through financial hardship. Since corporate debt structures and liquidity decisions are inextricably intertwined, every firm must keep an eye on how the two are related.

A bank that only provides micro-loans to people, companies, and organizations in low-income areas is known as a microfinance bank. The Microfinance Act establishes the regulatory, legal, and supervision structure that governs Kenya's microfinance business (2006) and the Microfinance Regulations (2019) (Association of Microfinance Institutions, 2013). In less than 10 years, there have been 13 licensed MFBs since Kenya's first MFB was established in 2019. As of December 2017, these 13 MFBs had over 114 branches (CBK 2018). The MFBs provide a framework for expanding and improving financial service access throughout Kenya, in either urban or rural areas.

A firm’s financing structure, which consists of equity and debt, directly influences its financial health and performance (Ado et al., 2020). Finding an optimal financing structure is challenging due to the need to balance liquidity, risk, and profitability, especially in volatile environments (Shubita & Alsawalhah, 2019). Typically, companies prefer internal financing, followed by debt, with equity financing as a last resort. Debt financing is a primary external source of funds, commonly used to raise capital for operational needs (Baltac & Ayaydn, 2018). Key financial metrics like the debt-to-equity ratio and leverage ratios assess a company's use of debt to finance its assets (Kasmir, 2018). In this study, the debt ratio, calculated as total debt to total assets, serves as the benchmark for evaluating debt usage (Nguyen & Nguyen, 2020). Equity financing involves issuing common or preferred stock, with share capital forming part of equity capital. While equity holders can influence managerial decisions through the board, issuing new shares could signal a lack of confidence, potentially lowering share prices (Nelson & Peter, 2019; Tahir et al., 2020). The stock market determines a firm’s share capital value, which is compared to the firm’s worth in financial statements to assess financial health (Yazdanfar et al., 2019). For microfinance banks (MFBs), customer deposits are a critical financing source. Deposits provide a low-cost liquidity source, crucial for bank stability and profitability (Mohan, 2019; Garo, 2019). Customer deposits refer to the funds placed by individuals, businesses, or other entities into a financial institution, typically a bank or microfinance institution. These deposits represent a liability for the bank and an asset for the depositor, as the institution is obligated to return the deposited funds on demand or at a specified time, along with any interest or returns due. The

types of customer deposits can include demand deposits (such as checking accounts), savings deposits, and fixed or time deposits (Aslam, 2018). The mobilization of deposits impacts bank performance, as they enable efficient lending and growth (Tuyishime et al., 2019). This study evaluates customer deposits through demand, savings, and fixed deposits (Dilrangi et al., 2018).

According to the 2013 CBK report, the Microfinance Amendment Bill of 2013 expanded the range of financial services and products that microfinance banks (MFBs) could offer, aiming to strengthen these institutions and enhance access to finance. By the end of 2013, six of the nine regulated MFBs had established Deposit-Taking (DT) marketing outlets. The total number of authorized DT-marketing branches saw a notable increase in 2013, rising from five in 2012 to 43 by December 2013. Additionally, customer deposits grew by 12.3%, from Ksh 43.8 billion in 2019 to Ksh 49.5 billion in 2020. This growth was driven by deposit mobilization through agency banking, mobile banking channels, and the full operational launch of Muungano MFB, which had received its license in November 2019 and began operations in 2020. Customer deposits and loans constituted 66% and 15%, respectively, of the total financing streams for MFBs. In Kenya, the minimum required liquidity ratio for MFBs is 20%. However, over the years, several MFBs have struggled to meet this threshold, negatively impacting their financial performance. Table 1.1 provides a summary of these MFBs and their liquidity positions.

Table 1. 1: Summary of MFBs and their liquidity positions duing the period (2013-2022)

Year	MFB	Minimum statutory level	Liquidity Ratio	Deficiency
2013	-	-		-
2014	Uwezo	20%	15%	-5%
2015	-	-	-	-
2016	Rafiki	20%	12%	-8%
	Century	20%	9%	-11%
2017	Rafiki	20%	19%	-1%
	Choice	20%	10%	-10%
2018	Choice	20%	3%	-17%
2019	Sumac	20%	3%	-17%
2020	Choice	20%	1%	-19%
	Daraja	20%	6%	-14%
2021	Daraja	20%	4%	-16%

Source: CBK (2013-2021)

1.2 Statement of Problem

Microfinance banks (MFBs) have played a crucial role in Kenya's economy by providing financial services to individuals typically excluded from traditional banking due to their irregular and low incomes. The liquidity position of MFBs was vital to their operations, requiring an optimal balance to ensure that liquidity was neither excessive nor insufficient. Excess liquidity could result in idle funds, which would negatively affect profitability, while inadequate liquidity could disrupt day-to-day operations. Achieving this balance was essential for the efficient functioning of MFBs. For many years, Kenya’s microfinance sector was marked by financial institutions' failure to meet their financial obligations. According to the Central Bank of Kenya (CBK) data, from 2012 to 2017, the liquidity levels of MFBs fluctuated between 25% and 36%,

with some institutions even recording ratios below the required 20%, indicating instability in their liquidity management (CBK Supervision Report, 2022). Liquidity ratios serve as key indicators of an institution's financial health and its operating environment. Anderson and Carverhill (2012) linked declining liquidity ratios to shifts in a company's financing structure, while Akbarpour and Aghabeygzadeh (2019) proposed that financial difficulties often stemmed from a company's funding structure. Additionally, Opungu (2019) emphasized that financing structure was a critical variable for corporate financial success. Altman's (1968) Multiple Discriminant Analysis (MDA) model showed that increasing financial leverage could improve financial outcomes. Empirical studies also suggested that capital structure significantly influenced key financial metrics, such as profitability, firm value, liquidity, and investment growth (Outecheva, 2007). However, literature reviews revealed conflicting findings across different studies.

Much of the research examining the link between financing structure and liquidity had been conducted in developed economies, focusing primarily on large listed companies (Oladele, Omotosho, & Adeniyi, 2017). In Kenya, research on the relationship between financing structure and liquidity within MFBs was limited (Rajendran & Achchuthan, 2013; Eton, Mwosi, Mutesigensi, & Ebong, 2017). Despite some efforts, empirical research on this relationship in emerging markets like Kenya was still nascent and fragmented (Akbarpour & Aghabeygzadeh, 2019; Younus et al., 2018; Isola & Akanni, 2019). Furthermore, previous studies on the link between financing structure and liquidity position yielded inconsistent results, often attributed to methodological challenges such as endogeneity and unobserved variable biases. Much of the existing research focused on the direct relationship between financing structure and liquidity in MFBs (Daiva & Liumila, 2018), but there was a lack of attention to moderating variables that could address these methodological issues.

Given the identified gaps in the methodology, the scarcity of empirical studies linking financing structure to the liquidity position of MFBs, and the conflicting results in previous research, this study aimed to explore the relationship between financing structure and liquidity position in Kenyan MFBs. By filling these gaps, the study sought to offer a more thorough understanding of the factors affecting liquidity in this sector.

1.3 Research Objectives

To establish the effect of financing structure on the liquidity position of microfinance banks in Kenya.

1.3.1 Specific Objectives

The research sought to achieve the following specific objectives:

i. To determine the effect of equity financing on the liquidity position of microfinance banks in Kenya.
ii. To establish the effect of customer deposits on the liquidity position of microfinance banks in Kenya.

1.4 Research Hypotheses

The study tested the following null hypotheses:

H_{01} : Equity financing has no significant effect on the liquidity position of microfinance banks in Kenya.
H_{02} : Customer deposits have no significant effect on the liquidity position of microfinance banks in Kenya.

1.5 Scope of Study

The study sought to investigate the effect of financial leverage on the liquidity positions of microfinance banks (MFBs) in Kenya. Specifically the study sought to determine the effect of equity financing and customer deposits on the liquidity positions of 13 MFBs operating in the Kenyan financial sector, that were regulated by the Central Bank of Kenya (CBK) as of December 31, 2021. These MFBs are primarily based in Nairobi County, which was the geographical focus of the study. The research employed a longitudinal approach, covering a ten-year period from 2012 to 2021, in order to analyze how the relationship between financial structure (Equity financing and Customer deposits) and liquidity positions of MFBs evolved over time.

2.0 LITERATURE REVIEW

The literature review explores both the theoretical and empirical aspects of how financial structure (Equity financing and Customer deposits) affects the liquidity positions of microfinance banks (MFBs) in Kenya. It is structured into two sections: the theoretical review, which addresses key financial theories relevant to the study, and the empirical review, which examines prior studies and research findings related to the topic.

2.1 Theoretical Review

This study investigated how various financing structures, such as customer deposits and equity financing, impacted the liquidity position of microfinance banks (MFBs) in Kenya. The three theories—Liquidity Preference Theory (LPT), Pecking Order Theory (POT), and Agency Theory—were instrumental in understanding the dynamics influencing liquidity management in MFBs. Liquidity Preference Theory (LPT), developed by Keynes (1936), asserted that individuals preferred liquid assets, such as cash, over illiquid investments. This theory was critical in the study, as it helped explain why MFBs had to maintain a balance between liquid assets and profitability. The focus on liquidity aligned with the study's objective to assess how MFBs managed their liquidity to meet financial obligations. Despite criticism, such as the theory's limited empirical support in real economies (Parguez, 2016), it remained relevant for understanding the liquidity needs of MFBs, as these institutions had to ensure sufficient liquidity to avoid financial instability.

Pecking Order Theory (POT) suggested that firms prioritized financing sources based on the cost of capital, using internal funds first, then debt, and finally equity (Myers & Majluf, 1984). This

hierarchy was significant for MFBs in Kenya, where internal resources like retained earnings were utilized before seeking external funding. The study's objective to evaluate how equity capital affected liquidity was directly informed by POT, as MFBs might have been cautious about issuing equity due to the associated costs and market perception (Tahir et al., 2020).

Agency Theory, proposed by Jensen and Meckling (1976), addressed the relationship between principals (shareholders or depositors) and agents (bank managers). This theory was relevant in the context of MFBs, where clients (depositors) entrusted funds to banks (agents) with the expectation of earning interest. The theory highlighted potential conflicts of interest, particularly in risk management and profit generation. It underscored the importance of effective management of customer deposits, which was critical for ensuring liquidity and meeting depositors' expectations (Chipeta, 2019).

In conclusion, these theories collectively helped explain the liquidity challenges faced by MFBs in Kenya, guiding the study's exploration of how equity capital and customer deposits impacted liquidity positions. While LPT emphasized the need for liquidity management, POT outlined the financing priorities, and Agency Theory focused on the agency relationship between depositors and banks. All three theories provided a comprehensive framework for understanding the dynamics of microfinance banking liquidity.

2.2 Empirical Review

In light of the study variables, the section reviews a variety of empirical studies. There are significant elements that have an impact on a firm's liquidity position, including microfinance banks. In this study, the liquidity position was based on equity capital and loan capital and how those two types of capital relate to the firms' liquidity positions. Several studies have explored the relationship between equity financing and the liquidity position of financial institutions, with mixed results due to contextual differences. Dudycz (2021) investigated how share capital affects business success, focusing on 259 initial public offerings (IPOs) on the Warsaw Stock Exchange. The study used multiple regressions and found that while a high share of equity capital could restrict capital flexibility, it was also an indicator of a company's strong performance in the market. This research highlighted that equity capital could make a company's capital less flexible, which can have important implications for managing liquidity.

In 2019, Collins Mbura Onyancha conducted a study to determine the influence of capital structure on the financial performance of insurance firms listed on the Nairobi Stock Exchange (NSE). The research, guided by variables such as debt, equity, and preference shares, employed a descriptive research design and secondary data collected from the NSE library. The findings revealed that debt capital significantly impacted financial performance, while equity also had a notable effect. It was recommended that insurance firms prioritize equity financing over borrowing to enhance performance.

Kiage, Wamugo, and Makori (2023) conducted a study to assess the impact of liquidity capacity on the financial performance of commercial banks in Kenya. Using an explanatory research design, the study analyzed data from 42 commercial banks over six years (2012–2018). Descriptive and inferential statistics, including panel regression and STATA software, were employed. The findings revealed that Net Stable Funding and Liquidity Coverage positively

impacted financial performance, while factors like Non-Performing Loan provisioning and Liquidity Gap had a negative effect. Bank competition significantly moderated the relationship.

Wambui and Muturi (2018) explored the effects of equity financing choices on the liquidity of banks, using data from the Nairobi Securities Exchange (NSE). They concluded that there was a weak positive relationship between equity financing and the liquidity of Kenyan listed commercial banks. This finding is limited by the fact that the study focused on commercial banks, which typically have better management and governance structures than microfinance banks (MFBs). Thus, their results might not directly apply to MFBs in Kenya, where governance structures are often weaker.

Mehmood and Rashid (2017) examined the relationship between equity market liquidity and corporate leverage in Pakistan, finding a significant inverse relationship. They observed that higher equity market liquidity was associated with lower leverage decisions, which could adversely impact corporate liquidity. This study, while useful, was based in a different context—Pakistan—where the regulatory and market environment may differ significantly from Kenya's. The current study aimed to address this gap by focusing on Kenyan MFBs.

Tarus, Chenuos, and Biwott (2018) analyzed the effects of profitability, business size, and liquidity on capital structure using data from 34 companies listed on the NSE. They found a strong negative correlation between capital structure and both profitability and liquidity. Their study, however, excluded financial institutions and focused on non-financial firms, making the findings less applicable to MFBs. This underscores the need for further research specific to MFBs, which have different liquidity dynamics.

Bilafif and Ibrahim (2019) investigated the effects of capital structure decisions on firm value in the manufacturing sector in Mombasa County. They found that an increase in retained earnings led to higher firm value. However, this research focused on manufacturing firms, which have distinct liquidity needs compared to MFBs, thereby limiting its direct applicability to the microfinance sector.

The relationship between customer deposits and liquidity position has also been a subject of considerable research, with several studies highlighting how different types of deposits impact financial outcomes. Madhubhashini et al. (2018) conducted a study on the correlation between demand, savings, and fixed-income deposits and the performance of commercial banks. They found a positive relationship between customer deposits and bank performance, suggesting that increased deposits, including demand, savings, and fixed deposits, contribute to improved financial outcomes. However, this study focused on commercial banks, which have more established banking systems compared to MFBs. This created a contextual gap, which the present study aimed to address by focusing on MFBs in Kenya.

Haddawea and Flayyih (2020) explored the relationship between bank deposits and profitability in Jordan, specifically examining the types of deposits that most influenced profitability. Their findings indicated a strong positive correlation, with savings deposits having the most significant impact. However, given that the study was conducted in a different financial environment, the findings may not be directly transferable to the Kenyan context. The current study sought to

bridge this gap by focusing on Kenyan MFBs. Baidoo, Bagina, and Tobazza (2018) established a positive correlation between customer deposits and the Bank of Ghana's financial performance, but they also found a negative correlation between deposits and liquidity, as measured by the current ratio. They emphasized that while customer deposits are crucial for banks' lending activities and income generation, managing these deposits is essential to maintaining stable liquidity. This study presented a gap in the understanding of the link between deposits and liquidity, which the current study aimed to close by focusing specifically on liquidity position.

Newman, Nkhambala, and Malatji (2021) examined how deposits affected the development and success of financial institutions. They confirmed a positive correlation between deposits and bank performance. However, their study focused on financial institution performance and growth, which is different from examining liquidity as the dependent variable. The current study aimed to fill this gap by using liquidity position as the focus, providing a more relevant framework for MFBs in Kenya. Okun (2019) explored how deposit levels influenced financial performance, specifically examining the correlation between deposits and return on equity (ROE) and return on assets (ROA). He found a positive correlation between deposit ratios and financial performance. However, as this study focused on commercial banks, which have different liquidity needs and regulatory frameworks than MFBs, the findings may not fully apply to MFBs in Kenya. This contextual gap was addressed in the present study, which focused on MFBs and their liquidity needs.

While previous studies provide valuable insights into the relationships between equity financing, customer deposits, and liquidity, their contextual limitations highlight the need for research focused specifically on MFBs in Kenya. The studies reviewed primarily explore commercial banks or financial institutions in different countries, which have distinct regulatory environments and liquidity dynamics. As such, their findings may not be directly applicable to MFBs in Kenya, where governance structures, market conditions, and liquidity management practices differ. This study aims to fill these gaps by focusing on MFBs in Kenya, providing insights into how equity financing and customer deposits influence their liquidity positions in a local context.

2.3 Conceptual Framework

The conceptual framework of this study demonstrated how MFBs' financing structure (Equity capital and Customer deposits) and liquidity situation relate to one another in Kenya. Figure 1 presents the conceptual framework for this study diagrammatically.

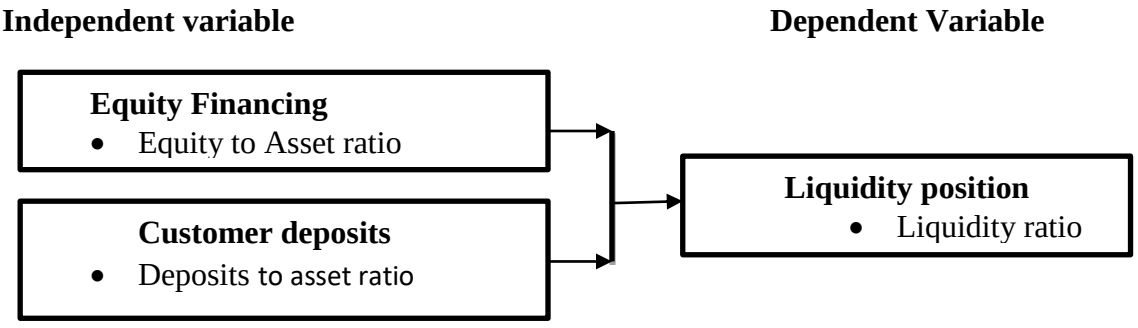

Figure 2. 1: Conceptual Framework

Source: Researcher (2024)

3.0 RESEARCH METHODOLOGY

The research utilized a positivist philosophy, which asserts that scientific claims are valid only when backed by empirical evidence (Crossan, 2003). An explanatory research approach was chosen to thoroughly explore the topic and develop a well-founded model. According to Mugenda and Mugenda (2009), explanatory research is ideal for studies that involve formulated hypotheses to explain the relationships between variables. The study focused on all the 13 microfinance banks (MFBs), and a census method was applied to collect data from all the institutions. Data was gathered over a period of 10 years, from 2012 to 2021, using secondary sources. These sources included supervisory reports from the Central Bank of Kenya (CBK) website and the publicly available financial statements of the MFBs. To analyze the data and determine the significance of the relationship between the independent and dependent variables, panel regression analysis was conducted, following the methodology proposed by MacKinnon & Fairchild (2009). The analysis was executed using STATA software (version 15.0) with a 95% confidence level. Additionally, descriptive statistics, including means, standard deviations, and the minimum and maximum values, were employed to complement the data analysis.

The following general empirical model was defined and adopted in the analysis:

$$\mathbf{LP_{it} = \alpha + \beta X_{it} + \varepsilon_{it}} \quad \text{(3.1)}$$

Where: $\mathbf{LP}_{it}$ is the Liquidity position of firm i at time t; *i* is a firm, i = 1…13; *t* is the period, t = 2012… 2021; $\mathbf{X}_{it}$ is the predictor variable vector; **β** is the beta coefficients; **α** is a constant term; $\boldsymbol{\varepsilon it}$ is the error term.

Equation 3.1 is expanded to obtain equations 3.2 which is used for estimation.

$$\mathbf{LP_{it} = \alpha + \beta_1 EC_{it} + \beta_2 DC_{it} + \beta_3 CD_{it} + \varepsilon_{it}} \quad \text{(3.2)}$$

Where;

$\mathbf{LP_{it}}$ = Liquidity position of firm i at time t; $\mathbf{EC_{it}}$ = Equity Capital of firm i at time t; $\mathbf{DC_{it}}$= Debt Capital of firm i at time t; $\mathbf{CD_{it}}$=Customer Deposit of firm i at time t; **α** = The constant term; $\boldsymbol{\beta_1}$-$\boldsymbol{\beta_3}$= The different independent variables' coefficients; Subscript i= companies with cross-sectional dimensions between one and thirteen; Subscript t = Years (time-series dimensions) from 2021 to the year 2012; and ε_{it} = error term.

4.0 RESULTS, FINDINGS AND DISCUSSION

This section presents the results and findings of the study, followed by a discussion of their implications. The analysis explores the relationship between financial leverage and the liquidity positions of microfinance banks in Kenya, offering insights into the effectiveness of financial sytructure in improving the liquidity positions of these institutions.

4.1 Descriptive Statistics

For the 2012–2021 study periods, these descriptive statistics provided information on the attributes of each variable, their distribution across all MFBs, and the observed trend. While the mean displays the means of the variables throughout the course of the study, the standard deviation displays the degree of variation. The data for analysis also included the highest and lowest values for the period.

Table 1: Summary Statistics for various variables

Variables	Obs	Mean	Std. Dev	Min	Max
Equity financing	130	.3540231	.0390024	.262	.446
Customer deposits	130	.3419385	.0439467	.229	.454
Liquidity position	130	.2858615	3.901204	.202	7.20

Source: Survey Data, 2024

The MFBs' liquidity position showed an unpredictable trend, according to the descriptive analysis's findings. This is due to the fact that the liquidity ratio revealed an average liquidity position of 28.6 percent, with a standard deviation of 390 percent, a minimum of 20.2 percent, and a maximum of 720 percent. A standard deviation of 3.9 implied there was a great variation in liquidity position among the MFBs during the study period from 2012 to 2021. Furthermore, the MFBs maintained a positive liquidity position during the period, as evidenced by their average liquidity position of 28.6%, which was higher than the legally mandated minimum level of liquidity ratio of 20%.

The equity-to assets ratio determined equity financing's place in an MFB's financing structure. According to Table 1, there has been a small variation in equity financing over time, as evidenced by the standard deviation of 0.039 and the mean value of 0.354 for equity financing over a ten-year period, respectively. Equity financing during the same period ranged from 0.446 to 0.262, the maximum and minimum values, respectively. The analysis comes to the conclusion that most MFBs were under geared during the time and mostly relied on internal financing to finance their assets, as opposed to a mean of 0.286 for loan financing. Customer deposits as a component of the financing structure of an MFB were determined using the deposits-to-assets ratio. Table 1 demonstrates that there has been very little fluctuation in customer deposits during the previous 10 years, with a mean value of 0.342 and a standard deviation of 0.439467. Customer deposits varied from 0.229 to 0.454 at their lowest and maximum points during that same time frame.

4.2 Regression Results

The foundation of this research is the hypothesis that financing structure and liquidity positions are correlated. Using a panel regression model with a liquidity ratio, the degree of the direct relationship between financing structure and liquidity position was ascertained. Regression analysis was also done to evaluate the various hypotheses' statistical significance. While the Wald chi2 assesses how well the general regression model fits the data, the coefficient of determination (R2) value indicates the percentage of variance in the dependent variable (liquidity

ratio) that can be anticipated from the predictor variables. The regression coefficients equal zero, according to the null hypothesis. The dependent variable's coefficient of determination and the Wald chi-squared test findings—the liquidity position as determined by the liquidity ratio—are displayed in Table 2.

Table 2: Test of Fitness

Liquidity ratio	Statistics
Wald chi2(2)	13.39
Prob>F	0.0211
R-Squared	0.4211

Source: Survey Data, 2024

Prob>F = 0.0211 is indicated by the study results in Table 2, where the outcome variable is the liquidity ratio. Because Prob>F = 0.0211 is less than 0.05 at the five percent level of significance, the study therefore rejects the hypothesis (Ho) that the coefficients of regression are equal to zero. As a result, the liquidity ratio, the outcome variable in the panel regression model, was suitable for analysis. According to the R-squared (0.4211), the financing structure accounts for 42.11% of the variation in the liquidity ratio, the dependent variable.

4.2 1 Test for Direct Effect

This study's objective was to ascertain how MFB's liquidity position was influenced by equity financing and customer deposits (see Table 3).

Table 3: Effect of Financing structure Practices on Liquidity position

Liquidity Position	Coefficient	Std. Error	Z	P>|z|	Model
Equity financing	.3451902	.1693582	2.04	0.044	
Customer deposits	.2025065	.0680842	2.97	0.004	
-Cons	.4793733	.0360499	13.30	0.000	

Source: Survey Data, 2024

As a result, the financing structure and liquidity position model were as follows:

$$\mathbf{Y = 0.48 + 0.20}\boldsymbol{X_1}\mathbf{ + 0.35}\boldsymbol{X_2}$$

Where; Y = Liquidity position; X_1 = Customer deposits; and X_2 = Equity financing

The results in Table 3 indicates that the liquidity position as determined by the liquidity ratio was predicted by client deposits, and equity financing.

4.1.2 Hypotheses Testing

H_{01}: Equity financing has no significant effect on the Liquidity position of MFB in Kenya

Establishing how equity financing affected the MFB's liquidity position in Kenya was the study's first, specific objective. Table 3 presents the results. To achieve this, a null hypothesis stating that equity financing had no significant effect on the liquidity position of MFBs in Kenya was developed. The equity financing to assets ratio (equity financing) in Table 3 (β =.3451902, p = 0.044 <0.05) indicates a statistically significant positive effect of equity financing on liquidity position. Thus, the null hypothesis—that is, equity financing has no significant effect on MFB's liquidity position—is rejected at the 5 percent level of significance. This suggests that equity financing improves MFB's liquidity position in Kenya.

The results showed a positive coefficient of 0.3451902, implying that, holding other factors constant, an increase of one unit in equity financing would result in an increase of 0.3451902 in the liquidity position. The positive finding supports the pecking order theory that was previously presented in the study. The results concur with those of Wambui and Muturi (2018). However, the findings were inconsistent with those of Frenzyied, (2013). The discrepancy might result from variations in the surrounding circumstances. Kenya operates within a frontier market, whereas the study conducted elsewhere was in a developed nation.

H_{02}: Customer deposits has no significant effect on the Liquidity position of MFB in Kenya

The third specific goal of the study was to ascertain how customer deposits affected MFB's liquidity position in Kenya. The results are shown in Table 3. In order to accomplish this, a null hypothesis was created, which claims that customer deposits have no appreciable effect on MFB's liquidity position in Kenya. Table 3 results establish that the liquidity position is positively affected by customer deposits, and since the coefficient of deposits to assets ratio (β =.2025065) and the p-value were less than 0.05 at the five percent level of significance, the null hypothesis—which stated that client deposits had no significant effect on MFB's liquidity position in Kenya—is thus rejected. Consequently, MFB's liquidity position in Kenya is positively, statistically, and significantly affected by customer deposits.

The positive coefficient of 0.2025065 means that an increase in client deposits by one unit would lead to an increase in the liquidity position by 0.2025065, assuming that other factors remain constant. The result corroborates those of Dilrangi et al. (2018), Baidoo et al. (2018), Okun (2019), Haddaweea and Flayyih's (2020), and Newman et al. (2021).

5.0 CONCLUSIONS

The findings of this study yield important conclusions regarding the liquidity positions of microfinance banks (MFBs) in Kenya, particularly concerning the effects of various financing structures. First, the study established a significant relationship between equity financing and the liquidity position of MFBs. It was found that MFBs relying more heavily on equity financing demonstrated better liquidity levels compared to those with a larger proportion of debt financing. This positive impact of equity financing suggests that it provides a more stable financial

foundation for MFBs, allowing them to navigate financial challenges more effectively. The results underscore the necessity of fostering an environment conducive to equity investments, as these funds can enhance liquidity and contribute to the overall financial health of microfinance institutions.

Second, the study demonstrated that customer deposits have a substantial positive effect on the liquidity status of MFBs. The analysis indicated that as customer deposits increase, the liquidity position of MFBs improves correspondingly. This highlights the critical role of customer trust and the effectiveness of deposit mobilization strategies in enhancing liquidity. It suggests that MFBs need to focus on creating attractive savings products and building strong relationships with their customers to boost deposit growth, thereby improving their overall liquidity situation.

6.0 RECOMMENDATIONS

In light of the current study's findings, certain policy recommendations and advice pertaining to the funding structure and liquidity situation of microfinance institutions might be made. The ideas are broken down into three categories: future research areas, practices, and policy implications.

5.1 Policy Recommendations

Based on the findings of the study, equity financing emerged as the most popular type of funding among microfinance banks (MFBs) in Kenya. The results demonstrated a significant and positive effect of equity financing on the liquidity position of these institutions, supporting the hypothesis that equity financing influences MFB liquidity. Therefore, it is recommended that policymakers, particularly the Central Bank of Kenya (CBK), encourage the diversification of equity sources. This can be achieved by offering incentives, such as tax breaks or subsidies, to attract potential investors. Additionally, establishing robust regulatory frameworks that promote transparency in equity financing practices is essential. Such measures will ensure that investors are well-informed about their investments and the associated risks, ultimately fostering a healthier investment environment for MFBs.

Regarding customer deposits, the study found a strong positive relationship between client deposits and the liquidity position of MFBs, validating the hypothesis that customer deposits significantly impact liquidity. To enhance this aspect, the CBK should promote a regulatory framework that encourages microfinance banks to innovate their savings products to attract more customer deposits. Additionally, educational campaigns aimed at raising awareness about the benefits of saving with MFBs can build customer trust and significantly increase deposit mobilization.

5.2 Recommendations to Practice

Given the study's findings that equity financing significantly and positively affects the liquidity position of microfinance banks (MFBs) in Kenya, it is recommended that these institutions actively pursue partnerships with potential investors. By implementing outreach programs and making presentations that highlight the advantages of investing in MFBs, banks can effectively communicate their value proposition. Improving marketing strategies to showcase success stories and positive impacts on communities will not only attract more equity investors but also enhance

their capital base. This strategic approach aligns with the need for diversified equity sources and will help create a more resilient financial foundation for MFBs.

The findings indicated a strong positive relationship between customer deposits and the liquidity position of MFBs. To capitalize on this, microfinance banks should implement customer engagement strategies that promote deposit growth and strengthen client relationships. Initiatives such as loyalty programs and incentive schemes can encourage existing customers to increase their deposits. Additionally, leveraging technology to enhance the convenience of deposit services, including mobile banking options, can attract a broader customer base. These efforts will not only improve liquidity but also build long-term trust and commitment from clients.

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