

Effect of Equity Financing on Liquidity Position of Microfinance Banks in Kenya

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DOI: 10.29322/IJSRP.14.06.2024.p15020
10.29322/IJSRP.14.06.2023.p15020

Paper Received Date: 05th May 2024
Paper Acceptance Date: 07th June 2024
Paper Publication Date: 15th June 2024

Abstract: The liquidity position of microfinance banks (MFBs) plays a pivotal role in their financial stability and ability to fulfill their mission of promoting financial inclusion and alleviating poverty in Kenya. Equity financing is a significant source of funding for MFBs, yet its impact on the liquidity position of MFBs remains unclear as documented in empirical evidence. Hence, this study investigates the impact of equity financing on the liquidity position of microfinance banks (MFBs) in Kenya and provides recommendations for policy and practice. Using panel data analysis covering the period from 2012 to 2021, the study examines the relationship between equity financing and liquidity position. The study findings indicate a significant link between equity financing and liquidity, with higher levels of equity contributing to enhanced liquidity positions within MFBs. Recommendations for policy makers include enhancing the regulatory framework governing MFBs to ensure prudent management of equity financing and promoting transparency and disclosure in financial reporting practices. For practitioners, the study recommends diversifying funding sources, investing in capacity building initiatives, and integrating equity financing considerations into strategic planning processes. In overall, the study underscores the importance of equity financing in supporting the liquidity position of MFBs in Kenya and offers actionable insights for policymakers and practitioners to enhance financial stability, resilience, and the promotion of financial inclusion.

Keywords: *Equity financing; Liquidity position; Liquidity; Microfinance banks; Capital structure.*

1.0 Introduction and Background

Microfinance banks in Kenya serve as crucial financial intermediaries, offering tailored services to individuals and businesses traditionally excluded from mainstream banking. Governed by the Microfinance Act and regulated by the Central Bank of Kenya (CBK), these institutions operate within a legal framework aimed at promoting financial inclusion (Shubita & Alsawalhah, 2019). Their core mission revolves around providing affordable and accessible financial products to low-income individuals, micro-entrepreneurs, and small businesses, ultimately empowering them economically. These banks offer a range of services designed to meet the diverse needs of their clientele. Microloans are a cornerstone offering, providing small-scale credit for income-generating activities, asset acquisition, or emergencies. Savings accounts, including group and targeted savings options, encourage savings mobilization among clients. Additionally, microfinance banks often provide micro-insurance products to mitigate risks faced by their

clients, covering areas such as health, life, and asset protection. Remittance services further contribute to financial inclusion by facilitating secure and convenient domestic and international money transfers (Ado et al., 2020).

The clientele of microfinance banks in Kenya predominantly comprises low-income individuals and small businesses operating in both rural and urban areas. These clients, often underserved by traditional banks, rely on microfinance institutions to access financial services tailored to their unique circumstances. To reach a wider audience, many microfinance banks have embraced technology, integrating mobile banking, agent banking, and digital payment solutions into their operations. These innovations expand access to financial services, particularly in remote and underserved regions (Baltac & Ayaydn, 2018). However, microfinance banks in Kenya encounter various challenges. Accessing affordable capital for lending remains a significant hurdle due to high costs and limited long-term financing options. Regulatory compliance, including meeting capital adequacy and liquidity requirements, adds another layer of complexity. Managing risks associated with serving low-income populations, such as credit and operational risks, is also a constant concern. Despite these challenges, microfinance banks continue to play a vital role in promoting financial inclusion, poverty reduction, and economic empowerment in Kenya.

In the context of microfinance banks in Kenya, liquidity holds paramount importance for their stability, growth, and ability to fulfill their social mission of financial inclusion. These institutions primarily serve low-income individuals, micro-entrepreneurs, and small businesses, many of whom rely heavily on timely access to financial services. Liquidity ensures that microfinance banks can meet the day-to-day needs of their clients, such as providing small-scale loans for income-generating activities or offering savings products to encourage financial resilience (Central Bank of Kenya, 2018). Additionally, liquidity enables microfinance banks to seize opportunities for expansion and investment within the Kenyan market. With readily available funds, they can extend their reach to underserved communities, establish new branches, or introduce innovative financial products tailored to the needs of their clientele. This flexibility not only enhances the institution's profitability but also strengthens its competitive position in the evolving financial landscape of Kenya.

Furthermore, liquidity plays a crucial role in managing risks inherent in serving low-income populations. Microfinance banks in Kenya often face challenges such as seasonal fluctuations in cash flows, credit risk associated with lending to informal sectors, and operational risks related to their outreach efforts in remote areas. Adequate liquidity buffers provide a safety net, allowing these institutions to navigate through economic uncertainties, mitigate potential losses, and maintain stability in their operations. Regulatory compliance is another aspect where liquidity is paramount for microfinance banks in Kenya. The Central Bank of Kenya imposes regulatory requirements, including minimum liquidity ratios, to ensure the stability and resilience of financial institutions (CBK, 2018). Compliance with these standards is essential for obtaining and maintaining a license to operate, demonstrating the institution's commitment to sound financial management and risk mitigation practices.

In summary, liquidity is indispensable for microfinance banks in Kenya as it underpins their ability to fulfill obligations to clients, capitalize on growth opportunities, manage risks, and comply with regulatory requirements. By maintaining adequate liquidity, these institutions can sustainably pursue their mission of promoting financial inclusion, poverty reduction, and economic empowerment across the country.

1.1 Microfinance Banks in Kenya

The regulatory, legal, and oversight framework for Kenya's microfinance industry is laid out in Microfinance Act of 2006 and Microfinance Regulations of 2019. 2013 (Association of Microfinance Institutions). The Microfinance Act of 2006 and its accompanying regulations of 2019 empowered the CBK to regulate and supervise MFBs in order to establish a robust, efficient, solid, and efficient microfinance banking company (Central Bank of Kenya, 2018). As stated by Anand and Kanwal (2019), the MFB constitutes a method of developing the abilities of the disadvantaged, who receive little attention by commercial banks as well as other lenders, and advancing them to long-term entrepreneurial endeavors by providing financial products and services such as financing, savings, and liability coverage. A profitable, efficient, solid, and solid microfinance banking company is consequently essential for guaranteeing that the impoverished and without a bank account get the opportunity to utilize banking services.

Based on the CBK report of the year 2013, in addition, the Microfinance Amendment Bill 2013 broadened the variety of financial services and products available to MFBs could possibly provide in order to reinforce entities and boost access to finance. Six of the 9 regulated microfinance institutions had DT marketing outlets as of the end of 2013. There was a significant growth in the total amount of these firms in 2013, from Five authorized DT-marketing branches in 2012 to 43 authorized as of December 2013. Furthermore, customer deposits increased by 12.3% from Ksh 43.8B in the year 2019 to Ksh 49.5B in the year 2020. Deposit mobilization using agency banking and cell-phone channels, in addition to Muungano MFB, which acquired its license in the month of November 2019 that begun full operations in 2020, were all drivers in deposit increase. Deposits from customers and loans accounted for sixty-six percent and fifteen per cent of total financing streams for microfinance institutions, accordingly.

In Kenya, the required minimum liquidity ratio is 20 percent. Several MFBs have over the years have failed to realize the minimum liquidity ratio of 20 percent which negatively affected their financial performance. Table 1 presents a summary of the said MFBs and their liquidity positions.

Table 1: Summary of MFBs and their liquidity positions during 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)

In examining the liquidity ratios of various microfinance banks in Kenya from 2014 to 2021, it is evident that these institutions consistently struggled to meet the minimum statutory liquidity requirement of 20%. This analysis reveals significant insights into the financial health and operational challenges faced by these banks. Starting with Uwezo in 2014, the liquidity ratio was reported at 15%, which is notably below the statutory minimum. This early indication of liquidity challenges set a concerning precedent for other microfinance institutions in the years that followed. Rafiki's liquidity ratio in 2016 was 12%, substantially lower than the required 20%, highlighting significant liquidity difficulties. However, by 2017, Rafiki's liquidity ratio improved to 19%. Despite this improvement, the ratio still fell short of compliance, indicating ongoing, albeit mitigated, liquidity issues. Century also faced severe liquidity constraints in 2016, with a ratio of just 9%. This is one of the lowest recorded among the institutions, pointing to critical financial instability during that period.

Choice Microfinance exhibited a particularly troubling trend. In 2017, Choice had a liquidity ratio of 10%, already below the statutory minimum. The situation worsened dramatically over the next few years, with the liquidity ratio dropping to 3% in 2018 and plummeting further to a mere 1% in 2020. This downward trajectory signifies a severe and escalating liquidity crisis, posing a significant threat to the institution's financial stability and operational viability. Sumac in 2019 had a liquidity ratio of 3%, reflecting severe liquidity challenges similar to those experienced by Choice. This low ratio underscores the institution's critical financial condition and potential difficulties in meeting short-term obligations.

Daraja's liquidity ratios in 2020 and 2021 were 6% and 4%, respectively. While these figures show a slight improvement year over year, they remain critically low and far below the statutory requirement, indicating persistent liquidity problems. None of the MFBs in Table 1, managed to achieve the minimum statutory liquidity ratio of 20% at any point during the observed years. This widespread non-compliance suggests systemic liquidity issues within the microfinance sector in Kenya. The trend analysis indicates that, while some institutions, like Rafiki, showed temporary improvements, others, such as Choice and Sumac, experienced severe and worsening liquidity crises.

The implications of these findings are profound. Persistent liquidity ratios below the statutory minimum can lead to significant risks, including insolvency and the inability to meet short-term obligations. Such financial instability can undermine depositor confidence and deter potential investors, further exacerbating the liquidity challenges.

1.2 Research Problem

Microfinance Banks (MFBs) play a pivotal role in the Kenyan economy by extending financial services to individuals often excluded from conventional banking channels due to their irregular and low income streams. The liquidity position of MFBs holds paramount importance for their operational sustainability, necessitating the maintenance of an optimal level of liquidity. Striking a balance between excess liquidity, which may lead to underutilization of funds and reduced profitability, and inadequate liquidity, which can disrupt corporate operations, is imperative for optimal functioning (Akbarpour & Aghabeygzadeh, 2019). The microfinance sector in

Kenya has grappled with persistent challenges in meeting its financial obligations over the years. According to statistics from the Central Bank of Kenya (CBK), liquidity ratios have witnessed a notable decline, plummeting from 61% in 2014 to 41% in 2021, despite a consistent double-digit growth rate in credit to the private sector (CBK, 2022). The liquidity ratio serves as a crucial metric, offering insights into the prevailing business environment and the overall financial health of a company at any given point in time. Anderson and Carverhill (2012) attribute the dwindling liquidity ratios to shifts in the firm's financing structure.

Akbarpour and Aghabeygzadeh (2019) have proposed that the principal catalyst for financial challenges in the business sphere is the aspect of funding. Moreover, Opungu (2019) has included financing structure among the nine variables associated with corporate financial success. Altman (1968), in his MDA model, discovered that increasing financial leverage positively influences company financial outcomes. These empirical findings suggest that the capital structure should exert an adverse impact on major financial performance metrics such as profitability, firm value, liquidity, and investment growth (Outecheva, 2007). However, a review of the literature reveals that various studies have yielded conflicting results. Numerous studies have explored the relationship between financing structure and liquidity situation, primarily focusing on listed corporations in developed economies (Oladele, Omotosho, & Adeniyi, 2017). However, research on this topic within the Kenyan context, especially concerning Microfinance Banks (MFBs), remains scarce (Rajendran & Achchuthan, 2013; Eton et al., 2017). Consequently, empirical research on the relationship between financing structure and liquidity position of MFBs in emerging economies, particularly in Kenya, is still in its nascent stages and fragmented (Akbarpour & Aghabeygzadeh, 2019; Younus et al., 2018; Isola & Akanni, 2019), despite ongoing efforts.

Furthermore, existing studies on this association have yielded contradictory results (Opungu, 2019; Githire & Muturi, 2019), with methodological issues such as endogeneity and hidden variable biases being cited as potential causes for inconsistencies. Given these methodological gaps, limited empirical literature linking equity financing to MFB liquidity position, and inconsistent findings, there was a need to investigate the effect of equity financing on the liquidity position of microfinance banks in Kenya.

1.3 Objective of the Study

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

1.4 Study hypothesis

H₀₁: Equity financing has no significant effect on liquidity position of microfinance banks in Kenya.

1.5 Scope of Study

The study aimed to investigate the relationship between the equity financing and liquidity positions of microfinance banks (MFBs) in Kenya. The primary target of the study was the microfinance banks operating within the Kenyan financial landscape. The target population comprised the 13 MFBs regulated by the Central Bank of Kenya (CBK) as of December 31, 2021. These MFBs were headquartered in Nairobi County, where the study was conducted. The research project adopted a longitudinal perspective, spanning a period of ten years from 2012 to 2021, to capture the relationship between asset financing and liquidity positions of the MFBs over time.

1.6 Value of the Study

The study on the effect of equity financing on the liquidity position of microfinance banks (MFBs) in Kenya holds significant implications for policymakers, management, and scholars alike. For policymakers, the findings provide valuable insights into the impact of equity financing on MFBs' liquidity, enabling them to tailor regulatory frameworks to better support the financial stability of MFBs. By understanding how equity financing influences liquidity, policymakers can implement measures to foster sustainable economic growth and enhance financial inclusion.

Management teams of MFBs can leverage the study's insights to make informed strategic decisions regarding their financing strategies. Understanding the relationship between equity financing and liquidity allows management to strike a balance that optimizes financial stability while minimizing liquidity risks. This knowledge empowers MFBs to manage their resources effectively and ensure uninterrupted operations. For scholars, the study contributes to the academic literature by providing empirical evidence on the dynamics of equity financing and liquidity management in MFBs. By advancing theoretical understanding and refining existing frameworks, scholars can enrich scholarly discourse on financial decision-making in emerging economies and the microfinance sector.

2.0 Literature Review

The literature review examines the theoretical and empirical foundations of how equity financing affects the liquidity of microfinance banks in Kenya. It is divided into two parts: the theoretical review, covering relevant financial theories, and the empirical review, discussing related previous studies.

2.1 Theoretical Review

The theoretical review covers two financial theories—the Pecking Order Theory and the Liquidity Preference Theory—that provide a framework for understanding how equity financing affects the liquidity positions of microfinance banks.

2.1.1 Pecking Order Theory

The Pecking Order Theory, proposed by Myers and Majluf in 1984. This theory suggests that firms have a preference for internal financing over external financing and prioritize funding their projects using retained earnings, followed by debt, and finally, equity issuance. In the context of microfinance banks in Kenya, the Pecking Order Theory can provide insights into their financing decisions. Microfinance banks often start with limited capital and rely on internal sources such as savings deposits and retained earnings to fund their initial operations and lending activities. This preference for internal financing aligns with the theory's assertion that firms prioritize using their own resources before seeking external funding.

As microfinance banks grow and expand their operations, they may encounter the need for additional capital to support their lending portfolio, invest in technology, or open new branches. At this stage, they may consider debt financing as a preferred option due to its lower cost compared to equity financing. Debt allows microfinance banks to leverage their existing capital base and generate higher returns on equity for their shareholders. However, there are limitations to debt financing, particularly for microfinance banks serving low-income populations. These institutions often face challenges in accessing affordable debt financing due to their risk profile and lack of collateral. Moreover, excessive reliance on debt can increase financial leverage and expose microfinance banks to greater risks, potentially compromising their stability and liquidity. In such circumstances, equity financing becomes a viable alternative for microfinance banks seeking to strengthen their capital base while maintaining financial flexibility. Equity issuance allows these institutions to raise funds without incurring debt obligations or pledging assets as collateral. Furthermore, equity investors, such as impact investors or development finance institutions, may provide strategic support and expertise, beyond mere capital infusion, which can be valuable for microfinance banks aiming for sustainable growth and social impact.

In summary, the Pecking Order Theory provides a theoretical framework for understanding the financing decisions of microfinance banks in Kenya. While these institutions may initially rely on internal financing and debt, equity financing becomes increasingly relevant as they expand their operations and seek to enhance their capital base to support liquidity, growth, and sustainability.

2.1.2 The Liquidity Preference Theory

In his seminal work, "The General Theory of Employment, Interest, and Money," economist John Maynard Keynes expounded upon the Liquidity Preference Theory. This theory posits that individuals possess a natural inclination to hold their wealth in liquid assets, prioritizing immediate access to funds over less liquid investments. Keynes's insights shed light on the behavior of market participants and their preferences regarding asset allocation (Gauti, 2019).

Applying Keynes's theory to the current study, the impact of equity financing on the liquidity position of microfinance institutions becomes apparent. When microfinance banks opt for equity financing, they introduce external investors into their ownership structure, thereby augmenting their capital reserves. The infusion of equity capital bolsters the liquidity position of these banks, aligning with Keynes's notion of the preference for liquid assets. This injection of funds provides a cushion against liquidity shocks and enhances the banks' ability to meet short-term obligations. Moreover, by diversifying their funding sources and reducing reliance on debt, microfinance banks mitigate liquidity risks and foster greater financial stability (Orichom & Omeke, 2021). However, the decision to pursue equity financing entails trade-offs. While it enhances liquidity in the short term, it may restrict the bank's autonomy and dilute existing ownership stakes. Furthermore, the allocation of equity capital towards expansion or investment initiatives may temporarily tie up liquidity, albeit with the potential for long-term growth and profitability (Eggertsson, 2019). In navigating these complexities, stakeholders must weigh the immediate liquidity benefits against the broader strategic implications of equity financing. By judiciously balancing liquidity preferences with long-term financial sustainability, microfinance banks can chart a course towards resilience and prosperity in the dynamic landscape of financial markets.

2.2 Empirical Review

This section provides a review of previous studies that explored how equity financing impacted liquidity positions, especially within financial institutions. Its aim was to offer empirical insights into the relationship between equity financing practices and liquidity dynamics specific to microfinance banks in Kenya. Dudydz's (2021) study delved into the impact of share capital on business success, focusing on a sample of 259 initial public offerings (IPOs) debuting on the Warsaw Stock Exchange. Utilizing multiple regression analysis, the research revealed that while a high proportion of equity capital may limit capital flexibility, it could also signify strong market performance. Additionally, the study found that market information efficiency tends to decline post-IPO, suggesting that pre-IPO accounting data has limited influence on post-IPO stock market performance. Consequently, the study concluded that an abundance of equity may render a company's capital less flexible.

Wambui and Muturi (2018) endeavored to assess the impact of equity financing decisions on the liquidity levels of banks. Employing a descriptive causal-comparative methodology, the study utilized data primarily sourced from the Nairobi Securities Exchange (NSE), serving as a secondary data source. The study's findings revealed a nuanced positive correlation between equity financing and the liquidity of listed commercial banks in Kenya. Notably, the research focused exclusively on these banks, which typically exhibit more robust management and governance frameworks compared to microfinance banks (MFBs). As a result, the outcomes of this investigation may diverge from those pertaining to MFBs.

Mehmood and Rashid (2017) conducted a study utilizing panel data spanning the years 2000–2013 to ascertain the impacts of equity liquidity. Their research explored diverse metrics of leverage and liquidity. The results revealed a notable and adverse association between equity market liquidity and corporate leverage decisions. It's important to note that this study was conducted in Pakistan, where the regulatory framework for the management and supervision of Microfinance Banks (MFBs) may differ from that in Kenya. Consequently, the present study aims to address this contextual gap by conducting research specific to the Kenyan context.

In their 2018 study, Tarus, Chenuos, and Biwott aimed to explore the relationships between profitability, business size, liquidity, and capital structure. They utilized panel data extracted from the yearly audited financial reports of 34 registered companies listed on the Nairobi Securities Exchange over a ten-year period spanning from 2006 to 2016. Notably, financial institutions were excluded from the dataset. The study's findings revealed a significant and adverse correlation between capital structure (CS) and both profitability and liquidity. The focus on listed firms at the NSE, operating within a distinct environment from Microfinance Banks (MFBs), suggested potential differences in outcomes. Hence, the authors underscored the necessity for a study specifically addressing MFBs to bridge the contextual gap.

In their 2019 study, Bilafif and Ibrahim sought to examine the impact of capital structure (CS) decisions on firm value within the manufacturing sector of Mombasa County. The research employed a descriptive research approach and involved a sample of 282 workers selected from carefully chosen publicly listed manufacturing companies in the region. Data collection encompassed structured questionnaires and financial statements sourced from Mombasa-based industrial firms. The study's findings indicated a positive relationship between retained earnings and firm value among listed manufacturing companies. Notably, the focus on manufacturing firms underscores their unique liquidity requirements, distinct from those of Microfinance Banks (MFBs).

Waithira and Mwangi (2022) compared the impact of equity financing on liquidity management across different microfinance banks in Kenya. The study adopted a mixed-methods approach, combining quantitative analysis with qualitative interviews. Quantitative data on equity financing and liquidity ratios were collected from annual reports of selected microfinance banks. The quantitative analysis revealed varying effects of equity financing on liquidity management among the sampled microfinance banks. While some banks showed a positive correlation between equity financing and liquidity position, others exhibited no significant relationship.

Kiptoo and Waweru (2024) examined the influence of equity financing on liquidity management practices in microfinance banks operating in Kenya. The study employed a mixed-methods approach, combining quantitative analysis with semi-structured interviews. Quantitative data on equity financing and liquidity ratios were collected from financial reports of selected microfinance banks over a five-year period. Semi-structured interviews were conducted with key stakeholders, including bank managers and regulatory authorities, to gather qualitative insights into the equity financing strategies and liquidity management practices adopted by microfinance banks. The quantitative analysis revealed a significant positive relationship between equity financing and liquidity management in Kenyan microfinance banks. Specifically, the findings indicated that microfinance banks with higher levels of equity financing tended to exhibit stronger liquidity positions. The qualitative interviews provided additional context, highlighting the role of regulatory frameworks, management practices, and market conditions in shaping the relationship between equity financing and liquidity management. Overall, the study underscored the importance of equity financing in enhancing liquidity management practices and promoting financial stability in microfinance banks operating in Kenya.

3.0 Methodology

The study adopted the positivism research philosophy, which emphasizes that scientific propositions can only be considered true if supported by empirical evidence (Crossan, 2003). To gain a deeper understanding of the issue and develop a well-investigated model, an explanatory research approach was employed. Mugenda and Mugenda (2009) states that explanatory design is the suitable research design for studies with constructed hypothesis that explain the interaction between the variables. The target population consisted of the 13 MFBs, and a census technique was used. The process of data collection spanned a duration of 10 years, covering the period from 2012 to 2021, encompassing secondary data sources. Secondary data was acquired from the supervisory reports on the CBK website and the public financial statements of the MFBs. To scrutinize the data and ascertain the significance of the relationship between the predictor variable and the outcome variable, panel regression analysis was utilized. This approach was endorsed by MacKinnon & Fairchild (2009). The analysis was performed using Stata software (version 14.0) with a confidence level of 95%. Descriptive statistics, such as means, standard deviation, maximum and minimum values, were also used to aid in data analysis.

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

$$LP_{it} = \alpha + \beta X_{it} + \varepsilon_{it} \dots \dots \dots (1)$$

Where: LP_{it} is the Liquidity position of firm i at time t ; i is a firm, $i = 1 \dots 13$; t is the period, $t = 2012 \dots 2021$; X_{it} is the predictor variable vector; β is the beta coefficient; α is a constant term and ε_{it} is the error term.

Equation 1 is expanded to obtain equation 2 which is used for estimation.

$$LP_{it} = \alpha + \beta_1 EC_{it} + \varepsilon_{it} \dots \dots \dots (2)$$

Where: LP_{it} is the Liquidity position of firm i at time t ; i is a firm, $i = 1 \dots 13$; t is the period, $t = 2012 \dots 2021$; X_{it} is the predictor variable vector; β is the beta coefficient; α is a constant term and ε_{it} is the 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 delves into the relationship between equity financing and the liquidity positions of microfinance banks in Kenya, providing insights into the effectiveness of equity financing strategies in enhancing liquidity position of the institutions.

4.1 Descriptive Statistics

The finding from the descriptive analysis suggests that the liquidity position of Microfinance Banks (MFBs) exhibited an unpredictable trend. This conclusion stems from the variability observed in the liquidity ratio across the sampled MFBs. Specifically, the average liquidity position was determined to be 28.6 percent, indicating the proportion of liquid assets held relative to total assets. However, the standard deviation of 0.941 percent signifies considerable dispersion or variability around this average liquidity position. This variability suggests that some MFBs may maintain significantly higher or lower levels of liquidity compared to the average. Moreover, the range between the minimum and maximum liquidity ratios further underscores the unpredictability of MFBs' liquidity positions. The minimum liquidity ratio of 20.2 percent indicates that some MFBs may operate with relatively low levels of liquidity, potentially exposing them to liquidity risk. Conversely, the maximum liquidity ratio of 720 percent suggests that certain MFBs may hold excessively high levels of liquid assets, which could affect their profitability or capital allocation efficiency. The equity-to assets ratio determined equity financing's place in an MFB's financing structure.

The equity-to-assets ratio sheds light on the role of equity financing within an MFB's overall financing structure. Based on Table 1, it appears that there has been relatively little fluctuation in total equity and total assets over the ten-year period under consideration. This observation is supported by the small standard deviation of 0.039, indicating a limited degree of variability around the mean value. The mean value of the equity-to-assets ratio, calculated as 0.354, suggests that, on average, approximately 35.4% of the MFB's assets are financed through equity. This indicates a significant reliance on equity financing as a source of funding for the MFB's operations and investments. Additionally, examining the range between the minimum and maximum values of the equity-to-assets ratio provides further insights. The minimum ratio of 0.262 indicates the lowest proportion of assets financed by equity observed within the dataset, while the maximum ratio of 0.446 represents the highest proportion. This range demonstrates the variability in the MFB's capital structure over the ten-year period, highlighting potential shifts in the balance between equity and other financing sources.

Overall, the equity-to-assets ratio analysis suggests that equity financing plays a substantial role in supporting the MFB's financial operations and investments. The relatively stable mean value, coupled with limited variability, indicates a consistent reliance on equity funding over time.

Table 1: Summary Statistics for various variables

Variables	Obs	Mean	Std. Dev	Min	Max
Equity financing	130	.354	.039	.262	.446
Liquidity position	130	.286	3.90	.202	7.20

Source: Survey Data, 2024

4.2 Regression Analysis

The foundation of this research is the hypothesis that equity financing and liquidity positions are correlated. Using a panel regression model with a liquidity ratio, the degree of the direct relationship between equity financing 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 variable. 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(4)	13.39
Prob>F	0.0211
R-Squared	0.4211

Source: Survey Data, 2024

The study's findings, as depicted in Table 2, indicate a Prob>F value of 0.0211 for the liquidity ratio, the outcome variable. This value is below the conventional significance threshold of 0.05 at the five percent level, leading to the rejection of the hypothesis (H1) that the regression coefficients are equal to zero. Consequently, the liquidity ratio is deemed suitable for analysis in the panel regression model. Furthermore, the R-squared value of 0.4211 suggests that equity financing accounts for approximately 42.11% of the variance observed in the liquidity ratio, the dependent variable. This indicates a moderate-to-strong explanatory power of equity financing in explaining variations in the liquidity ratio across the dataset.

4.3 Test for Direct Effect

The objective of this study was to investigate the impact of equity financing on the liquidity position of Microfinance Banks (MFBs), as outlined in Table 3.

Table 3: Effect of Equity Financing on Liquidity position

Liquidity Position	Coefficient	Std. Error	Z	P> z	Model
Equity financing	.345	.169	2.04	0.044	
-Cons	.479	.037	13.30	0.000	

Source: Survey Data, 2024

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

$$Y = 0.48 + 0.35X_1$$

Where; Y = Liquidity position; X₁ = Equity financing

The findings of the current study reveal that, with other factors held constant, the estimated liquidity position stood at 0.48. Moreover, the analysis highlighted the effect of equity financing on liquidity position, indicating that a one percent change in equity financing corresponded to a 0.35% variation in liquidity position. Consequently, the study rejected the null hypothesis, affirming a significant relationship between equity financing and the liquidity position of microfinance banks in Kenya.

Comparing these findings with Dudycz's (2021) study on the impact of share capital on business success, several distinctions and similarities emerge. While Dudycz focused on initial public offerings (IPOs) debuting on the Warsaw Stock Exchange, the current study examined microfinance banks in Kenya. Dudycz found that a high proportion of equity capital may limit capital flexibility but could also signify strong market performance. Similarly, the current study suggests that equity financing positively influences liquidity position, albeit with potential trade-offs. Wambui and Muturi (2018) also explored the impact of equity financing decisions on bank liquidity levels but focused exclusively on listed commercial banks in Kenya. Their findings, indicating a positive correlation between equity financing and bank liquidity, align with the current study's results, albeit within a different banking context.

Contrastingly, Mehmood and Rashid's (2017) study in Pakistan uncovered an adverse association between equity market liquidity and corporate leverage decisions. This differs from the current study's findings, which suggest a positive relationship between equity financing and microfinance bank liquidity in Kenya. Additionally, Tarus, Chenuos, and Biwott (2018) and Bilafif and Ibrahim (2019) examined the relationships between profitability, liquidity, and capital structure within various contexts, emphasizing the need for tailored investigations specific to microfinance banks. Overall, while previous studies offer valuable insights into the broader dynamics of equity financing and liquidity, the current study contributes to understanding these dynamics within the unique context of microfinance banks in Kenya.

5.0 Conclusions

Based on the findings of this study, it can be concluded that equity financing significantly influences the liquidity position of microfinance banks (MFBs) in Kenya. The analysis reveals a discernible relationship between equity financing and liquidity, indicating that MFBs' reliance on equity as a source of funding has implications for their liquidity management. Specifically, the study suggests that higher levels of equity financing may contribute to enhanced liquidity positions within MFBs, potentially bolstering their ability to meet short-term obligations and pursue growth opportunities. Furthermore, the study underscores the importance of equity financing as a strategic tool for MFBs to manage their liquidity risk and maintain financial stability. By maintaining a healthy balance between equity and debt, MFBs can mitigate the adverse effects of liquidity shocks and economic downturns, ensuring resilience in their operations.

However, it is important to note that the impact of equity financing on MFBs' liquidity position may vary depending on factors such as regulatory environment, market conditions, and internal management practices. Therefore, further research and analysis are warranted to explore these nuances and provide comprehensive insights into the relationship between equity financing and liquidity management in the context of MFBs in Kenya.

6.0 Recommendations

Based on the findings of the study on the effect of equity financing on the liquidity position of microfinance banks (MFBs) in Kenya, several recommendations can be proposed for policy and practice. Firstly, policymakers should consider enhancing the regulatory framework governing MFBs to ensure prudent management of equity financing. This could involve establishing guidelines on optimal capital structure ratios and liquidity requirements tailored to the unique characteristics of MFBs. Secondly, MFBs should explore opportunities to diversify their funding sources beyond equity financing. This could involve accessing debt financing from a variety of sources, such as development finance institutions, commercial banks, and capital markets, to enhance their liquidity position and mitigate risks associated with overreliance on equity.

Furthermore, MFBs should develop robust strategic plans that incorporate equity financing considerations into their overall business strategy. This could involve conducting thorough assessments of funding needs, risk tolerance, and growth objectives to inform equity financing decisions and ensure alignment with organizational goals. Additionally, MFBs should prioritize transparency and disclosure in their financial reporting practices, particularly regarding equity financing activities and liquidity management strategies. Clear and comprehensive disclosure can enhance investor confidence, facilitate access to capital markets, and support sustainable growth. Lastly, MFBs should establish robust monitoring and evaluation mechanisms to assess the effectiveness of equity financing initiatives and liquidity management practices. Regular reviews of key performance indicators and benchmarks can help identify areas for improvement and inform strategic decision-making. By implementing these recommendations, policymakers and practitioners can

enhance the effectiveness of equity financing in supporting the liquidity position of MFBs in Kenya, ultimately contributing to their financial stability, resilience, and ability to fulfill their mission of promoting financial inclusion and poverty reduction.

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