Financial Leverage, Income Diversification and Financial Sustainability of MFIs in Kenya

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Abstract

Background: Microfinance institutions are essential for promoting economic development and ensuring financial inclusion. Financial sustainability is crucial for the expansion of microfinance institutions and their ability to serve underprivileged borrowers.
Research Objective: The primary aim of this study was to determine the impact of financial leverage on the financial stability of MFIs, and to examine how revenue diversification influences this relationship.
Methodology: The study was conducted based on the pecking order theory and the contemporary portfolio theory. Data was collected from 32 Microfinance Institutions (MFIs) over 2010-2019.
Results and Findings: The study revealed that financial leverage has a negative and significant effect on the financial sustainability of MFIs. Conversely, income diversification had a positive effect on the financial sustainability of the MFI. Furthermore, the between the use of financial leverage and the diversification of income has an adverse effect on the financial MFIs.
Conclusions and Recommendations: The study advised that managers of Microfinance Institutions (MFIs) should have a clear understanding of the negative effect of debt financing on the MFIs' endeavours to achieve sustainability. Additionally, it is crucial for managers to comprehend the detrimental impact that arises from the interplay between leverage and non-interest earning activities. The results have significant implications for management of MFIs and policymakers, considering their crucial role in service delivery and the constraints that prohibit the sector from achieving financial sustainability in the economy.

Index Terms

Microfinance, Financial Sustainability, Leverage, Income Diversification, Kenya