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INTERNAL ENVIRONMENT AND FINANCIAL PERFORMANCE OF DEPOSIT TAKING MICROFINANCE INSTITUTIONS IN NAIROBI CITY COUNTY, KENYA

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ABSTRACT

This study examined the influence of internal environment on the financial performance of deposit-taking microfinance institutions in Nairobi City County, Kenya. The specific objectives of the study included to examine the effect of organization structure on the financial performance of deposit-taking microfinance institutions in Nairobi City county, Kenya and to find out the influence of organizational culture on the financial performance of deposit-taking microfinance institutions in Nairobi City county, Kenya. The study was premised on a descriptive research design. The study targeted management of the licensed deposit taking microfinance institutions. The data collection instruments were semi-structured questionnaires and the data collected was analyzed using SPSS. The research utilized both descriptive and inferential analysis. The descriptive results were presented using percentages and frequency tables. The research further utilized multiple regression model to estimate the effect of the independent variable on the dependent variable. For the qualitative data the study adopted content analysis. From the study we concluded that the type of organization structure, organization culture, information system adoption and resource capability affects the flow of information and work coordination in an organization and this has direct effect on financial performance of deposit taking microfinance institutions. One of the major areas which should be considered for further research is the relationship between employee motivation and financial performance of microfinance taking deposits. This area lacks enough literature and kept on coming throughout research process.

Key Words: *organization structure, organizational culture, Financial Performance*

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INTRODUCTION

Internal environment and control are a procedure, affected by an element's governing body, administration and other staff, intended to give sensible confirmation in regards to the accomplishment of a company's objectives in the adequacy and proficiency of activities, unwavering quality of money related and administration reporting, consistence with relevant laws, controls and secure the firm's reputation (Ngigi & Njeru, 2014). There are many controls that a DTMI can institute to protect its resources against loss to improve performance. A collection of internal controls put in place by the DTMI is what forms internal control system (ICS). Internal control is a topic that cuts across some disciplines including financial accounting and auditing. It can be traced back to ancient times. In Hellenistic Egypt, there was dual administration where one side was involved in the collation of taxes while the other supervising them (Ngigi & Njeru, 2014).

Performance in an organization reflects the result of the effects of implementation of various Strategies adopted by a firm. It is difficult to fairly assess the performance of deposit-taking Microfinance institutions. Different organizations use varying measures of performance. These measures may be quantitative or qualitative. Performance variables are both financial and non-financial (Flynn & Flynn, 2004). The success of any organization is manifested in attaining a competitive position or series of competitive positions that lead to superior and sustainable performance (Ngigi & Njeru, 2014). More so organizations are facing major challenges in maintaining commercial success. This is as a result of changes in the marketplace and emerging business practices. An organization may easily fall back due to the failure of not keeping up with the environmental changes (Albright, 2014).

An organization's internal environment is composed of the elements within the organization, including current employees, management, and especially corporate culture, which defines employee behavior. Although some elements affect the organization as a whole, others affect only the manager. Kuratko, Hornsby & Covin (2014) define internal business environment as the conditions, entities, events, and factors within an organization that influences its activities and choices, particularly the behavior of the employees. Factors that are frequently considered part of the internal environment include the organization's mission statement, leadership styles, and its organizational culture.

A survey conducted by CGAP in 2007 indicated that the majority of Sub-Saharan Africa countries are increasingly focusing their attention on regulating microfinance, CGAP. The study showed that microfinance is becoming more integrated into formal financial systems and in some countries; DTMIs are placed under the same law with commercial banks or under prudential regulation and supervision by the same authority.

The desire to serve clients better is the motivation for most MFIs transforming from a non-regulated microfinance institution to DTMIs, which are regulated. This was envisioned as an easier way to mobilize funds, greater outreach and a more efficient way of service delivery. Amongst the benefits of such transformation is cheaper access to funds through deposits, in the long run, increased governance and greater competitive position. This will perhaps contribute towards achieving greater financial performance leading to self-sustainability of the DTMI. Despite the fact that the 2006 Microfinance Act in Kenya permits deposits taking MFIs, such establishments showed up in Kenya in 2009 when two of the spearheading MFIs-Faulu Kenya and Kenya Women Finance Trust changed to deposit takers. Change of microcredit programs into a bank serving just low-pay customers is an old story that occurred in 1999 when K-Rep turned into the first commercial bank in Kenya to serve just low-salary customers, and the primary NGO in Africa to change into a regulated financial establishment, (Central Bank of Kenya, 2013). Financial inclusion stays to be a test for Kenya. There are 13 deposits taking microfinance institutions up to date that has plunged into the deposit-taking business.

Statement of the problem

With the order of the Microfinance Act of 2006 and issuance of the directions to implement it, MFIs in Kenya were out of the blue furnished with a lawful structure inside which to change particularly into deposit taking microfinance organizations (DTMIs). Beforehand, the main accessible choice in Kenya was for them to change into business banks. Proof from nations like Bolivia and Peru demonstrate that the change procedure isn't simple as MFIs confront an assortment of difficulties, for example, size of business, target clients, low financing costs, constrained credit per borrower and vowing of assets as security when getting ready for as well as amid change process. In any case, this accessible data isn't definitive on the relative importance of every one of those difficulties in change of MFIs. In addition, the principle model beforehand attempted in Kenya and different nations included change of MFIs into business banks. CBK (2015) reports indicates that only 5% of the total DTMI have grown to a full banking institution for the past ten years. This is a worrying trend as one would expect that the DTMI should grow to the next level given the large market base and many sources of funds they are exposed to in the market.

Ayuma (2015) cited access to financial information, prudential supervision, and cost of capital as determinants of financial risk of listed companies in the Nairobi Securities Exchange. Kiaritha (2015), highlighted internal politics, operating costs, savings culture investment policies as determinants of financial performance of SACCOs. He recommended that a replica study on other sectors using other factors that may influence financial performance. Makori *et al*. (2013) cited high dependency on short-term borrowing, lack of liquidity monitoring system, political interference, investment in non-earning assets and inadequate managerial competencies as some of the internal factors affecting performance of SACCOs. He recommended that organizations should embrace information technology as one of the internal factors and a similar research to be done on other sectors.

The internal regulation environment remains a precondition for deposit mobilization in many countries thus more DTMIs seek to transform into regulated entities to access cheap and local currency deposits. Regulation opens the door to a variety of funding opportunities and helps to reduce the overreliance on subsidies. Understanding how regulation affects performance regarding growth and moving to the next level. On one hand costs of designing and enforcing regulatory policies to address the specific challenges of microfinance are substantial and worth studying. The failure to compete and to grow from one level of operation to another has been linked to organizations internal environment (Shafiee, Razminia & Zeymaran, 2016). Therefore, considering the internal environment of DTMI in Kenya, this study explored how the internal conditions affect the financial execution of DTMI in Nairobi City County, Kenya.

Objectives of the study

The general purpose of the study was to examine the influence of internal environment on the financial performance of deposit-taking microfinance institutions in Nairobi City county, Kenya. The specific objectives were:-

- To examine the effect of organization structure on the financial performance of deposit-taking microfinance institutions in Nairobi City county, Kenya.

- To find out the influence of organizational culture on the financial performance of deposit-taking microfinance institutions in Nairobi City county, Kenya.

LITERATURE REVIEW

Theoretical Literature

Efficient Structure Theory

The efficient structure theory was developed by Demsetz (1973) premised on the need for an alternative explanation on market structure-performance relationship. The theory is premised on the concept that a business that operates more efficiently will achieve higher returns than other organizations at lower costs. The distinct operational efficiency levels within organizations help to create a better market share and an unequal market concentration. The efficient structure hypothesis (ES) is based on two main approaches the X-efficiency and the Scale efficiency. According to the x-efficiency the more profitable institution gains their advantage from cost efficiency. Such firms tend to gain high market shares which may be utilized in enhancing their market concentration levels (Athanasoglou, Brissimis, & Delis, 2008). On the other hand, the scale approach emphasizes on economies of scale rather than non-uniformity in management or production technology. That is larger firms can gain lower cost charges and higher profits by leveraging on the economies of scales. This enables such firms to enhance their market shares which can be manifested through higher profitability and concentration (Kolapo, 2012). The x-efficiency approach is key in underlying the need for DTMI to enhance their efficiency in production and service offering while the scale efficiency underscores the need for DTMI to utilize their earnings in a productive manner in order to gain higher profit margins and better market concentration. This theory will underline the need for DTMI strategic objectives to be formulated in line with the goals of the institution. Furthermore, the management of the DTMIs need to conduct a general analysis of the DTMI to ensure any approach adopted in developing the DTMI objectives is cognizant of the firm's capabilities and goals in achieving financial performance.

Contingency Theory

Contingency theories originate from structural approaches and organizational studies by Reid and Smith (2000) and Woods (2009); these studies postulated that organizational structure and culture was contingent on contextual factors such as technology, dimensions of task environment, control, values and organizational size which directly influence financial performance of the firm. Simply put, the contingency theory is an organizational theory that claims that there is no best way to organize a corporation, to lead a company, or to make decisions. Instead, the optimal course of action is contingent (dependent) upon the internal and external situations or factors. The contingency theory guides the review of the organization behavior by examining how key contingent factors such as technology, culture, and structure can guide and control the functions of the firm for better performance (Woods, 2009).

The main assumption of the theory is that no single culture or structure can be equally adopted within firms; rather the effectiveness of any institution is dependent on a strategic fit between different features of organization culture, structure, information systems and the environmental volatilities (Tillema, 2015). The contingency theory of organization, therefore, presently provides a major framework for the study of organizational design (Donaldson, 2001). It holds that the most effective organizational design is where the culture and structure fit the contingencies (Woods, 2005). The theory was in the study by linking how corporate culture and structure are integral to the organization performance of deposit-taking microfinance institutions.

Empirical Review

Financial Performance

Financial performance refers to the subjective measure of how well a firm can use assets from its primary mode of business and generate revenues. This term is also used as a general measure of a firms overall financial health over a given period and can be used to compare similar firms across the same industry or sectors in aggregation. Al-Jabri & Roztocki (2015) used growth rate analysis to analyze the growth in physical and financial performance indicators of horticultural producer's cooperative marketing society limited, Bangalore. The indicators considered were membership share capital, owned funds, sales, inventories, fixed assets, current assets, total assets, current liabilities and total liabilities.

Cameron and Quinn (2011) characterize money related execution as estimating the aftereffects of an association's arrangements and activities in fiscal terms and results are reflected in the association's arrival on speculation, return on resources and esteem included. It is basically the activity of accomplishing foreordained objectives and targets. Numerous researchers have grown freely the proportions of monetary execution any advanced firm can adjust. Benefit depicts how much riches your organization has made (benefit) or expended (misfortune) over a specific period. These figures are reflected in the benefit and misfortune record of the firm. Four helpful proportions of a company's benefit are the rate of profit for the association's assets (ROA), the rate of profit for the association's value (ROE), working overall revenue and net firm earnings.

Organization Structure and Financial Performance

Organizational structure has been described as the formalized arrangements of interactions between responsibilities for the tasks, people, and resources in an organization (Pearce & Robinson, 2013) organizational structure assists management in determining departments and functions in an organization, describing the hierarchy, control timeline and reporting relationships, communication systems, coordination and both horizontal and vertical integration across different organizational functions. Schaap (2006) posits that adjusting organizational structure to match a firm's strategy has a great significance to success in organizations. Various empirical literature has extensively explored the linkage between organizational structure, its many component, and financial performance. Katzenbach & Smith (2015) stated that organization size, technology, or environment was proposed as the single most important determinant of organization structure.

Wilden, Gudergan, and Lings (2013) described the organizational structure as a "contextual moderator" that is capable of determining the degree to which dynamic capabilities influence the firm's performance. The appropriate organizational structure is crucial to the achievement of the organization goals and objectives. It enables formulation of the right strategies to enable the organization to remain relevant with the environmental turbulence due to its flexibility in adapting to change (Shafiee, Razminia & Zeymaran, 2016).

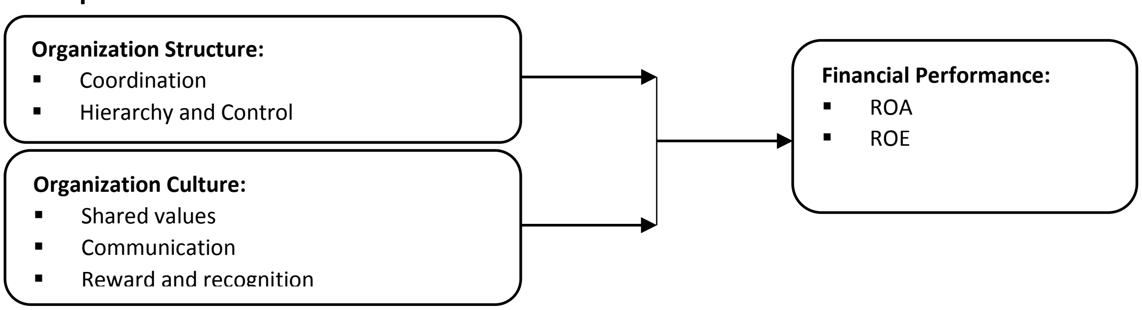
Organization Culture and Financial Performance

Organization culture affects how employees conduct themselves in the organization towards the attainment of organizational objectives. According to Glaser (2014), a positive organizational culture reinforces the core beliefs and behaviors that a leader desires while weakening the values and actions the leader rejects. Dobni & Klassen (2018) indicates that 'a negative culture becomes toxic, poisoning the life of the organization and hindering any future potential for growth. Kotter (2012) asserts that organizational culture has the potential to enhance organizational performance, employee job satisfaction, and the sense of certainty about problem-solving.

Knowing the culture of an organization allows employees to understand both the organization's history and current methods of operation. This insight provides guidance about expected future behaviors. It can foster a commitment to the organization's philosophy and values thereby generate shared feelings of working toward common goals. Organizational culture serves as a control mechanism to channel behaviors toward desired behaviors and away from undesired behaviors through its norms (Schein, 2011). This can also be accomplished by recruiting, selecting, and retaining employees whose values best fit the values of the organization. Certain types of organizational cultures may be related directly to greater effectiveness and productivity than others which explain the influence of organizational culture on performance.

Dobni & Klassen (2018) observe that culture is a strength but can also be a weakness. As a strength, culture can facilitate communication, decision making, and control, and create cooperation and commitment. As a weakness, culture may obstruct the smooth implementation of strategy by creating resistance to change. Whether organizational culture is strong, weak or moderate depends on factors of the organizational size, longevity of its existence, the level of circulation between employees and the beginning level of specified organizational culture. Some organizations do not state clearly what is important and what is not, and this neglect of priority is characteristic of the weak organizational culture. In such organizations, the culture will not have an immense impact on performance.

Conceptual Framework



Independent Variables **Dependent variable**

Figure 1: Conceptual Framework

Source: Researcher (2019)

METHODOLOGY

The study was premised on a descriptive research design while and study targeted management staff of licensed microfinance banks in Kenya. According to CBK (2016), 13 licensed DTMIs had 450 top, middle and lower level managers. This formed the study target population. The research used both primary and secondary data. The primary data was collected using semi- structured questionnaires. The research instruments in the study were carefully constructed to ensure their reliability and validity in the attainment of the objectives of the study. The collected data, both quantitative and qualitative was edited and entered for subsequent analysis in SPSS 23 using descriptive and inferential analysis. The research utilized both descriptive and inferential analysis.

RESULTS

Organization Structure and Financial Performance of DTMIs

The first objective of the study was to examine the effect of organization structure on the financial performance of deposit taking microfinance institutions. The results were recorded in table 1.

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Table 1: Organization Structure and Financial Performance of DTMIs

Statement	Total disagreement	Strong Disagreement	Slight Disagreement	Neutral	Slight Agreement	Strong Agreement	Total agreement.	Total
Organization structure fits into the institution goals	16%	11%	3%	19%	11%	13%	27%	100%
Effective communication within the organization fosters performance	17%	6%	6%	21%	7%	18%	25%	100%
Effective coordination within the institution promotes efficiency	4%	6%	2%	21%	8%	23%	36%	100%
Elaborate reward systems enhance the productivity within the institution	6%	1%	6%	21%	12%	14%	39%	100%
Control over internal operations fosters overall institution performance	4%	2%	4%	19%	11%	11%	50%	100%

Source: Researcher (2019)

Pearce & Robinson (2013) posits that organizational structure assists management in determining departments and functions in an organization, describing the hierarchy, control timeline and reporting relationships, communication systems coordination, both horizontal and vertical integration across different organizational functions. Wilden, Gudergan, and Lings (2013) described the organizational structure as a "contextual moderator" that is capable of determining the degree to which dynamic capabilities influence the firm's performance. The appropriate organizational structure is crucial to the achievement of the organization goals and objectives.

Jang and Kim (2014) conducted a study on public organizations and established that changes in organizational structure affected organizational performance. The study sampled employees from several such organizations and established that there were instances of ambiguity in job roles and poor communication which resulted to poor organizational performance both at the firm level and competitive market.

One of the questioned posts was the level of agreement on the statement that the current organization structure in which they work in fits the institutional goals and objectives. 16% of respondent totally disagreed with this statement, 11% strongly disagreed with the same statements, 19% of respondent were neutral on the statement while 27% and 13% of respondents totally agree and strongly agree respectively with the statement. On whether effective communication in line with the current organization structure foster performance, 17% of respondent posted total disagreement with the statement, 6% posted strong disagreement while 21% were neutral on the matter. 25% and 18% of respondents posted total agreement and strong agreement with the statement respectively.

The findings in this study concurred with Schaap (2006) who posits that adjusting organizational structure to match a firm's strategy has a great significance to success in organizations. He further stated that various empirical literature has extensively explored the linkage between organizational structure, its many components, and financial performance and the findings is similar that many organizations have failed to realign organization structure with organization objectives and where this is done, there is increased flow of communication which enhance firm performance.

The results further showed that over 50% of respondent totally agreed with the statement that control over internal operations fosters overall institution performance, 11% strongly agreed and slightly agreed respectively with the statement supporting the findings by Kumar and Meenakshi (2009) explaining that organizational structure supports effective controls. While according to Rajasekar (2014), organizational structure is said to provide a visual explanation of decision-making process and resource allocation. Additional factors include decision levels, a division of labor work systems and remuneration levels. Organizational structure is very common in organizational diagnostic models.

These findings were further supported by 39% total agreement with the statement on reward system. This supports the concept of internal promotion of the staff as a means of reward system and supports the findings by Wynarczyk et al., (2015) who investigated the influence of various attributes of organizational structure and financial survival of 176 financially stressed firms of the Caribbean nations from 1988-1996 using regression analysis. Their study findings established that firms that replaced their CEO with an outside director were more than twice as likely to experience bankruptcy larger levels of insider ownership are positively associated with the likelihood of firm survival. Van Grembergen & De Haes (2018) discussed ways many of those parts are related to one another and therefore affect the organizational structure. A complex structure has a greater need for communication across many departments horizontally or between many levels vertically. Therefore, the organization structure should be in a position to provide reward system through promotion and other means.

Organization Culture and Financial Performance of DTMIs

The second objective of this study was to investigate the influence of organizational culture on the financial performance of deposit-taking microfinance institutions in Kenya. The results of this objective were recorded in table 2.

Table 2: Organization Culture and Financial Performance of DTMIs

Statement	Total disagreement	Strong Disagreement	Slight Disagreement	Neutral	Slight Agreement	Strong Agreement	Total agreement.	Total
Poor adherence to organization culture limits financial performance within institutions	2%	1%	5%	19%	8%	20%	44%	100%
Effective communication within the institutions enhances performance	5%	5%	4%	19%	7%	13%	47%	100%
Employee motivation supports better financial performance	6%	5%	2%	14%	8%	18%	46%	100%
An elaborate rewards and recognition systems fosters financial performance	6%	4%	2%	20%	11%	11%	46%	100%
Internal recruitment enhances organization learning which promotes performance.	10%	4%	2%	35%	8%	13%	29%	100%

Source: Researcher (2019)

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According to Glaser (2014), a positive organizational culture reinforces the core beliefs and behaviors that a leader desires while weakening the values and actions the leader rejects. Dobni & Klassen (2018) indicates that a negative culture becomes toxic, poisoning the life of the organization and hindering any future potential for growth. Kotter (2012) asserts that organizational culture has the potential to enhance organizational performance, employee job satisfaction, and the sense of certainty about problem-solving.

First the researcher sought the level of agreement on the statement that poor adherence to organization culture limits financial performance within institutions where 44% of respondents totally agreed with the statement, 20% strongly agreed while only 2% thought otherwise. This shows that there is a correlation between adherence to organization culture and the financial performance and supports the findings by Cameron and Quinn (2011) who concluded reviews have demonstrated that hierarchical culture directly affects other indispensable execution results of any association. It includes consumer loyalty and business development across a wide spectrum of business and industries.

Singh (2011) further asserts that an organization's culture could be characterized as weak when many subcultures exist, few values and behavioral norms are shared, and traditions are rare. In such organizations, employees do not have a sense of commitment, loyalty, and a sense of identity. Rather than being members of an organization, these are wage-earners. Traits adopted by organizations that have weak cultures include politicized organizational environment, hostility to change, promoting bureaucracy in preference to creativity and entrepreneurship, and unwillingness to look outside the organization for the best practices.

On whether effective communication within institutions enhances performance, 47% of the respondents posted total agreement with the statement, 19% were not sure while 13% and 5% strongly agreeing and strongly disagreeing respectively. Dobni & Klassen (2018) observe that culture is a strength but can also be a weakness. As a strength, culture can facilitate communication, decision making, and control, and create cooperation and commitment. As a weakness, culture may obstruct the smooth implementation of strategy by creating resistance to change

The researcher asked on whether the culture of internal recruitment enhances organization learning which promotes performance, 10% of respondent posted total disagreement with the statement, 35% were not sure while 13% and 29% of respondent strongly agreed and totally agreed with the statement respectively. These results indicate that a positive culture bolsters adjustment and improves representatives' job execution by rousing, molding their practices towards the fulfillment of corporate targets.

The results further reveal that 46% of respondents believes that an elaborate rewards and recognition systems fosters financial performance and 46% believes that employee motivation supports better financial performance. Therefore, we can conclude that no change will give reasonable execution except if an association's way of life and representatives are completely arranged and adjusted to help that change. Culture is the thing that recognizes genuinely high-performing associations from the rest. Corporate culture significantly affects associations' long-haul manageability and financial execution.

CONCLUSIONS

From the study we concluded that the type of organization structure affects the flow of information and work coordination in an organization and this has direct effect on financial performance of deposit taking microfinance institutions. Therefore, there is need for organization to adjust their organizational structure to match a firm's strategy has this will greatly influence the success in terms of financial performance.

The study revealed that organization culture is one of the important determinants of financial performance with positive coefficient. Culture influence employee loyalty which in turn affects customer loyalty and it further determines the employee reward systems all of which determines the financial success of the organization.

RECOMMENDATIONS

The organization should match their organization structure with their long-term strategic plan. The structure should be a lean structure which allow for smooth and effective flow of information and work.

The Deposit taking Microfinance Institutions' should ensure that they have culture that motivates their employees and gives them opportunity to grow in their areas of profession.

Areas of further research

One of the major areas which should be considered for further research is the relationship between employee motivation and financial performance of microfinance taking deposits. This area lacks enough literature and kept on coming throughout research process.

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