



EFFECT OF COST MANAGEMENT ON THE PERFORMANCE OF MICROFINANCE BANKS IN NAIROBI COUNTY, KENYA

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ABSTRACT

Microfinance banks play a critical role in Kenya's financial system by extending credit and savings services to low-income households and small and medium enterprises that remain outside the reach of mainstream commercial banks. Despite this importance, the sector has recorded persistent financial distress, with total assets, loan portfolios and profitability declining steadily between 2021 and 2024. This study examined the effect of cost management on the performance of microfinance banks in Nairobi County, Kenya. The study was anchored on the Resource-Based View. A cross-sectional survey design was adopted, targeting 98 departmental heads drawn from the 14 licensed microfinance banks headquartered in Nairobi County, using a census approach. Primary data were collected using a structured questionnaire based on a five-point Likert scale. A pilot study was conducted at Kenya Women Microfinance Bank (KWFT), Kiambu Branch, to test the validity and reliability of the research instrument, with cost management recording a Content Validity Index of 0.872 and a Cronbach's Alpha of 0.878. A response rate of 89.8% ($n = 88$) was achieved. Data were analysed using SPSS Version 30 through descriptive statistics, Pearson correlation and regression analysis. The findings revealed a moderate to strong level of cost management practice among microfinance banks (Mean = 3.6269, SD = 1.3163), with institutions performing best at implementing cost-reduction measures without compromising service quality but weaker at aligning budget allocation with strategic priorities. Cost management exhibited a moderately strong, positive and statistically significant correlation with performance ($r = 0.553$, $p = 0.000$), and regression analysis confirmed that cost management has a statistically significant positive effect on performance ($B = 0.293$, $\beta = 0.195$, $p = 0.010$). The study concludes that disciplined expenditure monitoring, variance review, and strategically guided resource allocation strengthen the performance of microfinance banks in Nairobi County. It is recommended that management strengthen the linkage between budgeting processes and strategic priorities by institutionalising periodic strategic budget reviews, and that regulators and industry bodies develop frameworks that embed cost discipline into strategic planning.

KEYWORDS: Cost Management, Performance, Microfinance Banks, Nairobi County, Kenya

1. INTRODUCTION

Strategic management literature acknowledges that strategy is one of the factors that shape the performance of firms, as it determines how organizations respond to the environment in which they operate and to their competitive challenges (Durango, Lara-Rubio, Galera & Blanco-Oliver, 2022). Among the strategic capabilities available to financial institutions, cost management, the strategic planning and control of organizational costs to ensure efficient utilization of financial resources while supporting organizational objectives, is widely regarded as central to institutional sustainability (Baltas, Kalyvas & Casu, 2025). For microfinance banks operating in a highly regulated, low-margin and increasingly competitive industry, the discipline with which an institution monitors expenditure, reviews cost variances and allocates scarce financial resources according to strategic priorities can determine whether resources are converted into sustainable growth or eroded through avoidable operating losses, (Golovkova, Eklöf, Malova & Podkorytova, 2019).

Strategy shapes how organizations allocate resources and respond to the competitive environments in which they operate. Cost management is one such capability. It refers to the strategic planning and control of organizational costs to ensure efficient use of financial resources while supporting organizational objectives (Durango, Lara-Rubio, Galera & Blanco-Oliver, 2022). It covers three related activities: monitoring expenditure against approved budgets (cost control), identifying and removing unnecessary operating expenses (cost reduction), and directing scarce resources toward strategic priorities (resource allocation), (Molla, Kaur, Goymer & Waweru, 2025). For financial institutions that earn thin margins on small-value transactions, these activities are a core part of running the business rather than a back-office concern.

Globally, the microfinance industry has continued to expand in scale. The global microfinance market was valued at approximately USD 215.51 billion in 2024, and digital micro-lending alone is projected to grow by 30 percent as providers digitise loan origination and repayment channels (Coinlaw, 2025). This growth places heavy demands on the cost base of individual institutions, which must fund technology, compliance, staffing and outreach while serving clients whose loan sizes are small and whose servicing cost per



client is proportionally high. Microfinance providers are also expected to remain financially sustainable while fulfilling a social mandate of serving low-income populations and small enterprises that lack access to conventional banking facilities (Abdelkader, 2023). Balancing these two expectations makes the control of costs a permanent management concern.

In Africa, microfinance institutions operate in markets that differ widely in their economic conditions, and their financial outcomes differ accordingly. Ethiopia's microfinance sector, for example, recorded a profit of about USD 3.7 billion in 2025 as deposits grew by 22.6 percent (Finance in Africa, 2025). Gains of this kind depend on favourable macro-financial conditions, which institutions do not control. Costs are the part of the income statement that management can influence directly. Institutions across the continent also face rising expenses from mobile-based service delivery, regulatory compliance and competition from fintech lenders, and these pressures increase the importance of managing expenditure carefully.

In Kenya, microfinance banks were licensed under the Microfinance Act (2006) to extend formal financial services to low-income households and micro, small and medium enterprises that commercial banks were unable or unwilling to serve (Muli, 2025). They now compete with commercial banks moving down-market, savings and credit cooperatives, and mobile money and digital credit providers. This competition limits their ability to raise prices or lending rates, which leaves cost control as one of the few levers available for protecting margins. The financial position of the sector shows why this matter. Microfinance banks have posted losses consistently since 2016, reaching KSh 3.5 billion in 2024 (Intelpoint, 2025), while shrinking deposits have pushed sector assets to a decade low (Businessfront, 2025).

Nairobi County is the appropriate setting for examining cost management in this sector. It hosts the headquarters of the 14 microfinance banks licensed by the Central Bank of Kenya, and therefore the departmental heads who approve budgets, set expenditure limits, review cost variances and allocate resources across branch networks. It is also the most competitive market for financial services in the country. Institutions here face continuous cost pressure from staffing, technology, premises and loan impairment, alongside the expectation that they will grow their asset bases and loan books.

Performance in this study refers to the extent to which a microfinance bank achieves its financial and operational objectives, measured through asset growth, market share and loan portfolio growth (King'ori, Kioko & Shikumo, 2020). On these measures, performance in the sector has deteriorated. Total assets declined from KSh 73.9 billion in 2021 to KSh 70.4 billion in 2022, while the net loan portfolio fell from KSh 40.1 billion to KSh 39.3 billion. Pre-tax losses rose from KSh 980 million in 2022 to KSh 2.391 billion in 2023, and in 2024 losses widened to KSh 3.531 billion while the loan portfolio fell to KSh 31.180 billion (Central Bank of Kenya, 2025). The Central Bank of Kenya attributes part of this decline to weak credit growth and high impairment costs. Both are cost-related pressures that better expenditure control and resource allocation could help address. It is therefore not clear whether the cost management practices in use among microfinance banks in Nairobi County are strong enough to protect performance. This study examines the effect of cost management on the performance of microfinance banks in Nairobi County, Kenya, to provide evidence that management, regulators and industry bodies can use to strengthen cost discipline in the sector.

2. STATEMENT OF THE PROBLEM

Microfinance banks play a critical role in Kenya's financial system by providing credit and savings services to low-income and previously unbanked populations. Despite the expectation that disciplined cost management would strengthen financial performance, microfinance banks in Kenya continue to experience persistent financial distress. Total assets declined from KSh 73.9 billion in 2021 to KSh 70.4 billion in 2022, while the net loan portfolio fell from KSh 40.1 billion to KSh 39.3 billion. Pre-tax losses increased from KSh 980 million in 2022 to KSh 2.391 billion in 2023, while the net loan portfolio declined further to KSh 37.467 billion. In 2024, losses rose to KSh 3.531 billion and the loan portfolio fell to KSh 31.180 billion (Central Bank of Kenya, 2025). The Central Bank of Kenya attributes part of this decline to weak credit growth and high impairment costs, pointing to shortcomings in cost management practices within the sector.

Existing empirical studies have examined determinants of microfinance bank performance in Kenya, but few have isolated cost management as a distinct explanatory factor. King'ori, Kioko and Shikumo (2020) examined operational efficiency, capital adequacy, firm size, liquidity and credit risk as determinants of microfinance bank performance nationally, while Nyangaresi and Simiyu (2024) focused narrowly on financial risk categories, neither disaggregating the specific contribution of cost management. Muli (2025) examined firm characteristics, including management efficiency, and the financial performance of licensed microfinance banks in Kenya, establishing a significant positive correlation, but did not focus specifically on Nairobi County microfinance banks nor isolate cost management as a discrete construct measured through expenditure monitoring, cost reduction and strategic resource allocation. This study therefore sought to fill this contextual and conceptual gap by examining the effect of cost management, specifically expenditure control, cost reduction and strategic resource allocation, on the performance of microfinance banks in Nairobi County, Kenya.



3. OBJECTIVE OF THE STUDY

To determine the effect of cost management on the performance of microfinance banks in Nairobi County, Kenya.

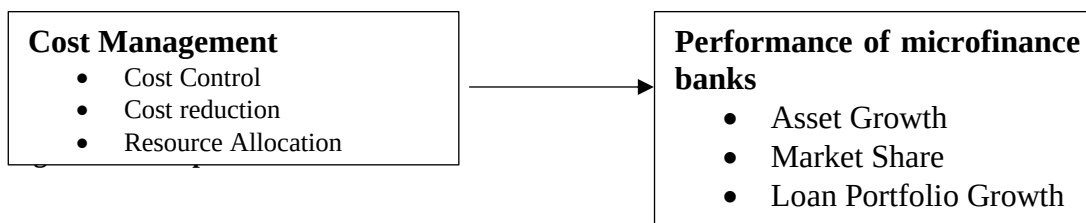
4. LITERATURE REVIEW

The study is anchored on the Resource-Based View, advanced by Barney (1991), which holds that firms achieve sustained competitive advantage by owning and deploying resources that are valuable, rare, imperfectly imitable, and non-substitutable. Rather than locating the source of competitive advantage in industry structure, the theory places it within the firm itself, in bundles of financial, physical, human and organizational capital that competitors cannot easily replicate (Barney, 2001). Applied to cost management, the theory suggests that a microfinance bank's ability to control expenditure, negotiate favourable pricing, and allocate scarce financial resources efficiently constitutes a valuable internal capability that can translate directly into superior and defensible financial performance.

The Resource-Based View is credited with two principal strengths. Barney (2001), in a ten-year retrospective on the theory, showed that positioning firm resources relative to structure-conduct-performance and evolutionary economic traditions offered a coherent explanation for persistent performance differences among firms operating in identical markets, while Bhandari, Rangarajan, Yaqub and Wasan (2022) demonstrated that resource heterogeneity continues to explain sustainable competitive advantage even when extended to contemporary concerns such as environmental, social and governance performance. The theory has, however, been criticised on conceptual grounds. Priem and Butler (2001) argued that the theory is not fully falsifiable because its central proposition, that valuable and rare resources generate competitive advantage, is tautological, while Kraaijenbrink, Spender and Groen (2010) noted that the definitions of "resource" and "value" remain indeterminate and that the theory offers limited practical guidance on how managers should identify valuable resources in advance.

The relevance of the Resource-Based View to this study lies in its capacity to explain cost management, defined as the disciplined and systematic internal allocation and control of financial resources, as a source of competitive advantage for microfinance banks. It offers a rational basis for the proposition that institutions which manage costs better than their competitors can translate this internal capability into superior financial performance.

Conceptual Framework



Cost management, in this study, refers to the strategic planning and control of organizational costs to ensure efficient utilization of financial resources while supporting organizational objectives (Durango, Lara-Rubio, Galera & Blanco-Oliver, 2022), and is measured through cost control, cost reduction and strategic resource allocation. Performance is measured through asset growth, market share and loan portfolio growth over the period 2021–2025 (King'ori, Kioko & Shikumo, 2020).

Empirical Review

Durango, Lara-Rubio, Galera and Blanco-Oliver (2022) examined the impact of pricing strategy on the efficiency and self-sustainability of microfinance institutions. Pricing strategy was the independent variable, and efficiency and self-sustainability were the dependent variables. The study adopted a case-study design using panel data envelopment analysis on a sample of microfinance institutions. The results showed that pricing strategy has a significant impact on cost efficiency and long-run self-sustainability, as clients were less likely to be retained and efficiency gains were reduced by over-aggressive pricing. The study concluded that sustainable performance of microfinance institutions is founded on disciplined, cost-reflective pricing rather than aggressive cost-cutting.

Saeed, Mudliar and Kumari (2023) studied financial management practices, competitive advantage and loan performance of microfinance institutions in the Ashanti Region of Ghana. Financial management practices and competitive advantage were the independent variables, and loan performance was the dependent variable. The study adopted a cross-sectional design, with 85 microfinance institutions selected based on Krejcie and Morgan guidelines, and primary data gathered from credit directors and risk managers were analysed using regression analysis. The results indicated that financial management practices had a positive and significant effect on competitive advantage and loan performance. The study found that the success of microfinance competitiveness requires good cost and financial management.



Using data from the MENA region, Abdelkader (2023) investigated the social and financial performance of microfinance institutions and their determinants. The independent variables were institutional and macroeconomic variables, and social and financial performance were the dependent variables. A quantitative panel design, based on data from 79 microfinance institutions obtained from the MIX database, was used, and the data were analysed by panel regression. The results indicated that key institutional factors, including cost and legal-status factors, were important influences on financial performance, and that there was a trade-off between financial performance and outreach to female borrowers. The study found a cost-conscious institutional design to be a mediator of the outreach-profitability trade-off.

Nyangaesi and Simiyu (2024) studied financial risk and profitability of microfinance banks in Kenya. The independent variables were credit risk, liquidity risk, operational risk and market risk, and the dependent variable was profitability. A descriptive research design was used, and secondary data obtained from financial statements of microfinance banks were analysed by panel regression. The results showed that credit, liquidity and operational risk significantly and negatively affected profitability, while market risk had no significant effect. The researchers found that good use of operational cost and risk controls is a critical factor for profitability. Muli (2025) studied firm characteristics and financial performance of licensed microfinance banks in Kenya. Capital adequacy, management efficiency and bank size were the independent variables, and financial performance was the dependent variable. A descriptive correlational design was used with panel data on licensed microfinance banks, analysed by correlation and regression technique. The results showed that the capital adequacy ratio had a significant positive correlation with financial performance, and that management efficiency was also significantly and positively correlated with financial performance. The study found that the performance of microfinance banks is greatly shaped by internal cost and capital management practices.

Collectively, this literature suggests that cost management, encompassing cost control, cost reduction and strategic resource allocation, is theorised to enhance the financial performance of microfinance banks by strengthening their capacity to absorb shocks, invest selectively, and sustain lending operations while protecting service quality.

5. METHODOLOGY

This study adopted a cross-sectional survey research design to examine the effect of cost management on the performance of microfinance banks in Nairobi County, Kenya. The target population comprised 98 departmental heads drawn from the 14 licensed microfinance banks headquartered in Nairobi County. Since the population was small, the study adopted a census approach, targeting all 98 respondents rather than drawing a sample. Primary data were collected using a structured questionnaire based on a five-point Likert scale (1 = Strongly Disagree to 5 = Strongly Agree), administered through the drop-and-pick-later method.

A pilot study involving approximately 10% of the target population (10 respondents) was conducted at Kenya Women Microfinance Bank (KWFT), Kiambu Branch, to test the validity and reliability of the research instrument. Content validity was established through expert evaluation by the university supervisors, with cost management recording a Content Validity Index of 0.872, above the recommended threshold of 0.80. Reliability was assessed using Cronbach's Alpha, with cost management recording a coefficient of 0.878, above the acceptable threshold of 0.70 (Hair et al., 2022).

Data were analysed using SPSS Version 30 through descriptive statistics (means and standard deviations) and inferential statistics, including Pearson correlation and regression analysis, to determine the relationship between cost management and the performance of microfinance banks. Diagnostic tests confirmed that the data satisfied the assumptions underlying regression analysis: the multicollinearity test returned a Tolerance of 0.724 and a Variance Inflation Factor of 1.381 for cost management, both within acceptable limits, while the autocorrelation test returned a Durbin-Watson statistic of 1.897, within the acceptable range of 1.5 to 2.5. The regression model was expressed as:

$$Y = \beta_0 + \beta_1 X_1 + \varepsilon$$

Where:

Y = Performance of Microfinance Banks

X₁ = Cost Management

β₀ = Constant

β₁ = Regression coefficient

ε = Error term

6. RESULTS

6.1 Response Rate

Of the 98 questionnaires administered to departmental heads across the 14 licensed microfinance banks in Nairobi County, 88 (89.80%) were correctly filled and returned, while 10 (10.20%) were not returned, largely because a few departmental heads were unavailable during the data collection period or declined to complete the instrument due to competing work schedules. Table 1 presents the response rate achieved in the study.

Table 1: Response Rate

Response	Number of Respondents	Percentage (%)
Expected responses	98	100%
Received responses	88	89.80%
Responses not received	10	10.20%

Source: Research Data (2026)

This response rate exceeds the 70% threshold regarded as sufficient for survey-based studies (Mugenda & Mugenda, 2019), and is adequate to ensure that the findings can be generalised to the population of microfinance banks in Nairobi County. The high response rate indicates the willingness of departmental heads to participate and that the data obtained is sufficient to test the study's regression model.

6.2 Descriptive Statistics

6.2.1 Cost Management

The study sought to determine the effect of cost management on the performance of microfinance banks in Nairobi County. Table 2 presents the descriptive results.

Table 2: Cost Management

Statement	N	Min	Max	Mean	Std. Dev.
The institution closely monitors operating expenditures against approved budgets.	88	1.00	5.00	3.4886	1.39782
Expenditure variances are reviewed to ensure that costs remain within approved limits.	88	1.00	5.00	3.6705	1.31062
The institution regularly identifies opportunities to reduce unnecessary operating costs.	88	1.00	5.00	3.6023	1.36912
Cost-reduction measures are implemented without compromising the quality of financial services.	88	1.00	5.00	3.8864	1.17866
Financial resources are allocated according to the institution's strategic priorities.	88	1.00	5.00	3.4773	1.19364
Human and financial resources are reallocated when strategic priorities change.	88	1.00	5.00	3.6364	1.44780
Overall Mean and Std. Deviation				3.6269	1.3163

Source: Research Data (2026)

The findings indicate a moderate to strong embedment of cost management practices among microfinance banks in Nairobi County, with an overall mean of 3.6269 and a standard deviation of 1.3163. The most highly rated practice was the implementation of cost-reduction measures without compromising service quality (Mean = 3.8864, SD = 1.17866), indicating that institutions are keen to maintain service quality while reducing costs. Variance reviews of expenditure (Mean = 3.6705, SD = 1.31062) and the reallocation of resources as strategic priorities change (Mean = 3.6364, SD = 1.44780) both point to reasonably active budgetary control, while the regular identification of opportunities to reduce unnecessary operating costs recorded a mean of 3.6023 (SD = 1.36912), suggesting that cost-consciousness is fairly well embedded in day-to-day operations. The lowest-rated statements were the allocation of resources according to strategic priorities (Mean = 3.4773, SD = 1.19364) and the monitoring of operating expenditure against approved budgets (Mean = 3.4886, SD = 1.39782), indicating that the link between budgeting and strategic prioritisation is comparatively weaker.

The relatively high standard deviations across all items indicate considerable variation in how consistently different microfinance banks apply cost management practices. These findings align with Muli (2025), who found that internal cost and capital management practices significantly shape the financial performance of licensed microfinance banks in Kenya, and with Durango, Lara-Rubio, Galera and Blanco-Oliver (2022), who found that disciplined, cost-reflective practices, rather than aggressive cost-cutting, help microfinance institutions succeed in the long run.

6.2.2 Performance of Microfinance Banks

Table 3 presents the descriptive results for the dependent variable, performance of microfinance banks in Nairobi County.

Table 3: Performance of Microfinance Banks

Statement	N	Min	Max	Mean	Std. Dev.
The institution has recorded consistent growth in its total asset base over the last five years.	88	1.00	5.00	2.4432	1.46890
The institution's asset base has expanded relative to previous years.	88	1.00	5.00	2.5114	1.35608
The institution has strengthened its share of the microfinance banking market over the last five years.	88	1.00	5.00	2.4886	1.42227
The institution has maintained or increased its market position relative to competing microfinance banks over the last five years.	88	1.00	5.00	2.3636	1.18595
The institution has experienced consistent growth in its total loan portfolio over the last five years.	88	1.00	5.00	2.3523	1.20382
The value of loans outstanding has increased consistently over the last five years.	88	1.00	5.00	2.4659	1.32134
Overall Mean and Std. Deviation				2.4375	1.3264

Source: Research Data (2026)

The performance of microfinance banks recorded a low overall mean (Mean = 2.4375, SD = 1.3264), with every individual item falling below the scale midpoint of 3.0, indicating generally weak performance outcomes over the past five years. The asset base having expanded relative to previous years recorded the highest mean of the construct (2.5114, SD = 1.35608), while consistent growth in the total loan portfolio recorded the lowest mean (2.3523, SD = 1.20382), the weakest-performing item overall. These findings corroborate the sector-level evidence cited in the study's problem statement, that total assets, loan portfolios and profitability of Kenyan microfinance banks declined steadily between 2021 and 2024 (Central Bank of Kenya, 2025).

6.3 Inferential Statistics

6.3.1 Correlation Analysis

Pearson correlation analysis was used to establish the strength and direction of the relationship between cost management and the performance of microfinance banks. Table 4 presents the results.

Table 4: Correlation Analysis

	Performance
Cost Management – Pearson Correlation	.553**
Sig. (2-tailed)	.000
N	88

****.** Correlation is significant at the 0.01 level (2-tailed). Source:

Cost management and the performance of microfinance banks exhibit a moderately strong, positive and statistically significant correlation ($r = 0.553$, $p = 0.000$, $N = 88$), indicating that microfinance banks with more disciplined cost management practices tend to record stronger performance outcomes. This finding confirms Muli (2025), who established a significant positive correlation between management efficiency, closely related to cost management, and the financial performance of licensed microfinance banks in Kenya.

6.3.2 Regression Analysis

Cost management was regressed against the performance of microfinance banks together with the other Analyzer-typology dimensions examined in the parent study (operational efficiency, market dynamics and customer acquisition), which were included as statistical controls. The overall model was statistically significant ($R = 0.820$, $R^2 = 0.673$, Adjusted $R^2 = 0.657$, $F(4, 83) = 42.694$, $p = 0.000$), jointly explaining 67.3% of the variance in performance. Table 5 presents the coefficient specific to cost management.

Table 5: Regression Coefficient for Cost Management

Model	B	Std. Error	Beta	t	Sig.
(Constant)	-1.714	.429		-3.990	.000
Cost Management	0.293	0.111	0.195	2.641	0.010

Source: Research Data (2026)

The results indicate that cost management has a positive and statistically significant effect on the performance of microfinance banks ($B = 0.293$, $\beta = 0.195$, $t = 2.641$, $p = 0.010$). This means that, holding operational efficiency, market dynamics and customer acquisition constant, a unit increase in cost management practice is associated with a 0.293-unit improvement in performance. Expressed net of the other predictors, the relationship is:

$$Y = -1.714 + 0.293$$

The intercept of -1.714 has no meaningful standalone interpretation, since none of the predictors can realistically be zero in practice, but it is necessary to anchor the model mathematically. The positive and significant coefficient for cost management supports Muli



(2025) and Saeed, Mudliar and Kumari (2023), both of whom found that disciplined cost and financial management practices are significantly and positively associated with the financial performance of microfinance institutions.

7. CONCLUSION

Based on the analysis, it was established that cost management has a statistically significant positive effect on the performance of microfinance banks in Nairobi County. Descriptive results showed a moderately strong level of cost management practice, with institutions performing well at implementing cost-reduction measures without sacrificing service quality but comparatively weaker at aligning budget allocation with strategic priorities. The correlation analysis revealed a moderately strong positive relationship between cost management and performance, and the regression results confirmed that cost management has a statistically significant positive effect on performance even after controlling for operational efficiency, market dynamics and customer acquisition. Disciplined expenditure monitoring, variance review, and strategically guided resource allocation enable institutions to protect service quality while controlling costs, thereby strengthening financial sustainability. These results are in line with the Resource-Based View (Barney, 1991, 2001), which holds that the efficient and disciplined deployment of valuable financial resources is a primary source of sustained competitive advantage. They also overlap with Muli (2025), who associated management efficiency with the financial performance of microfinance banks, and Durango, Lara-Rubio, Galera and Blanco-Oliver (2022), who described the importance of cost-reflective discipline in sustaining microfinance viability. The outcomes affirm that good cost management practices strengthen financial stability, which contributes to the performance of microfinance banks.

8. RECOMMENDATIONS

The study recommends that management of microfinance banks strengthen the linkage between budgeting processes and strategic priorities, beyond simply monitoring expenditure, by institutionalising periodic strategic budget reviews that reallocate resources as strategic priorities shift.

The Central Bank of Kenya and the Association of Microfinance Institutions in Kenya should develop supervisory guidance that embeds cost discipline, including expenditure monitoring, cost-reduction targets and resource allocation frameworks, into the strategic planning processes required of licensed microfinance banks.

Banking institutions should also invest in centralised training, digital onboarding, and performance-based incentive structures, which have been associated with reduced staff cost per active client while sustaining outreach, in order to further strengthen the link between cost management and financial performance.

Future studies may examine the combined effect of cost management alongside other strategic dimensions, such as operational efficiency, market responsiveness and customer acquisition, on microfinance bank performance over a longitudinal period, and could employ objective secondary financial data, such as cost-to-income ratios, to complement the perceptual survey data used in this study.

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