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Risk Identification Practices and Financial Performance: Evidence from Microfinance Institutions in Nairobi County, Kenya

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Abstract

Risk identification practices are increasingly important in the microfinance sector, where institutions operate amid credit, liquidity, operational, market, and emerging risks. Effective risk identification enables institutions to take corrective measures, minimize losses, and sustain financial performance. This study examined the effect of risk identification practices on the financial performance of microfinance institutions in Nairobi County, Kenya. Guided by Enterprise Risk Management Theory, the study adopted a positivist philosophy, a descriptive and correlational research design, and a quantitative approach. The target population comprised managers, risk officers, credit officers, and finance officers in licensed microfinance institutions. The study collected primary data using structured five-point Likert-scale questionnaires. Of 165 questionnaires issued, 144 were returned, representing an 87.3% response rate. We analyzed the data in SPSS using descriptive statistics, Pearson correlation, and simple linear regression. Risk identification practices were generally implemented ($M = 3.95$, $SD = 1.15$), with risk prioritization recording the highest mean ($M = 4.06$) and documented risk mapping the lowest ($M = 3.74$). Risk identification practices were strongly and positively related to financial performance ($r = 0.638$, $p < 0.01$). Regression results showed that risk identification explained 40.7% of the variation in financial performance ($R^2 = 0.407$), with a positive and significant effect ($\beta = 0.218$, $t = 2.907$, $p = 0.004$). The model was statistically significant, $F(1, 142) = 97.21$, $p < 0.001$. A pilot study of 10 respondents across two microfinance institutions in Kiambu County showed satisfactory reliability, with Cronbach's alpha coefficients ranging from 0.812 to 0.879 and an overall alpha of 0.861. The study concluded that risk identification practices significantly influenced financial performance. It recommends strengthening risk mapping, early-warning systems, employee risk awareness, and identification and prioritization of emerging risks, while maintaining systematic documentation of identified risks across institutional functions and decision-making processes at all levels.

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Keywords: *Risk identification practices, financial performance, microfinance institutions, risk management, Nairobi County, Kenya*.

1.0 Introduction

Microfinance institutions (MFIs) play an important role in promoting financial inclusion by providing credit and other financial services to individuals and small businesses with limited access to conventional banking services. Their sustainability is therefore important for maintaining access to finance and supporting economic activity. However, MFIs operate in an environment characterized by credit, liquidity, market, operational, and other financial risks, making effective risk management essential for institutional stability and profitability. Recent evidence shows that risk management practices are closely linked to MFIs' financial performance and sustainability, although the nature and magnitude of the relationship may vary across institutions and operating environments (Baltas, 2024; Molla & Kaur, 2025). Risk identification represents an important initial stage of risk management because it enables institutions to recognize potential threats before they adversely affect operations and financial outcomes. Effective identification involves systematically recognizing existing and emerging risks, assessing their possible sources, and understanding their potential consequences. For MFIs, early identification of credit, operational, liquidity, and market risks can support timely risk responses and reduce the likelihood of financial losses. Recent research emphasizes that MFIs need comprehensive risk management approaches rather than focusing exclusively on credit risk, because multiple risks can affect financial performance (Molla & Kaur, 2025).

Globally, empirical evidence shows the importance of risk management to MFI performance. Molla and Kaur (2025), using evidence from Ethiopian MFIs, established that several risk-related factors were significantly associated with financial performance, highlighting the importance of effective risk management for institutional sustainability. Similarly, Baltas (2024) found that financial risk management practices were associated with efficiency, asset quality, and solvency among MFIs. These findings suggest that MFIs' ability to identify and respond to risks can improve financial outcomes. In Africa, MFIs continue to operate under considerable financial and regulatory pressures, increasing the importance of systematic risk identification and management. Evidence from Sub-Saharan Africa indicates that financial regulation and risk management are important considerations in explaining MFI performance (Nambie et al., 2024). The findings reinforce the view that institutions need effective systems to identify potential risks and develop appropriate responses to protect their financial position. In Kenya, risk management is particularly important in the microfinance sector. Research has established relationships between various risk management practices and the financial performance of Kenyan MFIs. For instance, a study of Kenyan MFIs found that market risk factors, including interest rate and foreign exchange risks, significantly affected financial performance (2021). More recent Kenyan research has similarly demonstrated that risk management practices influence MFI financial performance, with recommendations emphasizing the need to strengthen the capacity of financial managers and credit officers to identify, assess, and mitigate risks (Peter & Atandi, 2025).

The financial condition of Kenya's microfinance banking sector further demonstrates the relevance of effective risk management. The Central Bank of Kenya reported that microfinance banks recorded continued losses, while their loan portfolio, capital adequacy, and return indicators deteriorated between 2023 and 2024. In 2024, the sector's net loan portfolio declined from Sh 37.47 billion to Sh 31.18 billion, while return on assets remained negative. Such developments

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underline the need for MFIs to strengthen mechanisms that enable them to identify potential risks early and take corrective action before such risks undermine financial performance.

Despite growing attention to risk management, existing studies have largely focused on broad financial risk management, credit risk, liquidity risk, or market risk, with comparatively less attention to risk identification practices as an independent determinant of financial performance. Recent Kenyan studies have also tended to examine risk management as a broad construct or focus on particular risk categories rather than isolating the contribution of risk identification. This creates a contextual and empirical gap regarding whether effective risk identification practices improve financial performance among MFIs operating in Nairobi County. Therefore, this study examines the effect of risk identification practices on the financial performance of microfinance institutions in Nairobi County, Kenya.

1.1 Statement of the Problem

Ideally, microfinance institutions (MFIs) should maintain strong financial performance characterized by sustained profitability, growth in assets and loan portfolios, adequate liquidity, and improved financial sustainability. Effective risk identification should support this ideal by enabling institutions to recognize emerging credit, liquidity, operational, and market risks early and respond appropriately before these risks translate into financial losses. Recent evidence indicates that effective risk management improves asset quality, solvency, and institutional efficiency among MFIs (Baltas, 2024). Therefore, MFIs with effective risk identification mechanisms should maintain stable financial performance despite operating in a risk-prone financial environment. However, the actual performance of Kenya's microfinance banking sector is concerning. According to the Central Bank of Kenya (CBK), the sector's total assets declined by 9.8%, from Sh. 64.2 billion in 2023 to Sh. 57.9 billion in 2024, while net advances declined by 16.8%, from Sh. 37.5 billion to Sh. 31.2 billion.

The sector also continued to deteriorate in financial soundness, with microfinance banks recording losses for six consecutive years. The situation is further reflected in deteriorating asset quality, as gross non-performing loans increased from Sh. 12.1 billion in June 2023 to Sh. 12.3 billion in June 2024, while customer deposits declined by 4.2% over the same period. These indicators suggest weaknesses in profitability, asset growth, loan portfolio performance, and financial sustainability, raising concerns about the effectiveness of existing risk management practices. Although previous Kenyan studies have shown that broader risk management practices, credit risk management, and other risk-management dimensions influence MFI financial performance, limited empirical attention has focused specifically on risk identification practices as a distinct determinant of financial performance, particularly in the Nairobi County context. For example, recent studies have examined credit risk management and general risk management among Kenyan MFIs but have not sufficiently isolated how identifying potential risks contributes to financial outcomes. This creates an empirical and contextual gap that the current study seeks to address by specifically determining the effect of risk identification practices on the financial performance of microfinance institutions in Nairobi County, Kenya.

1.2 Objective of the Study

To determine the effect of risk identification practice on the financial performance of microfinance institutions in Nairobi County, Kenya.

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1.4 Research Hypothesis

H_0: Risk identification practice has no statistically significant effect on the financial performance of microfinance institutions in Nairobi County, Kenya.

1.5 Significance of the Study

The study was significant because it provided empirical evidence on the effect of risk identification practices on the financial performance of microfinance institutions in Nairobi County, Kenya. The findings were useful to microfinance institution management by showing how effective identification of credit, liquidity, operational, and market risks could support profitability, asset growth, loan portfolio performance, and financial sustainability. The study also benefited regulators and policymakers, particularly the Central Bank of Kenya, by providing evidence to inform stronger risk management guidelines and regulatory measures in the microfinance sector. In addition, the study contributed to the existing body of academic knowledge by focusing specifically on risk identification as a distinct risk management practice and provided a basis for future researchers to undertake related studies in other financial institutions and geographical contexts. Finally, the findings were useful to clients, investors, and development agencies by highlighting the importance of effective risk identification in promoting the stability, sustainability, and continued provision of financial services by microfinance institutions.

2.1 Theoretical Review

Enterprise Risk Management (ERM) Theory was advanced by Lam (2003) as an integrated approach to managing the different risks faced by an organization. The theory posited that organizations could better achieve their objectives by systematically identifying, assessing, responding to, and monitoring risks across the organization rather than managing risks in isolation. The COSO (2017) framework further strengthened this approach by integrating risk management with strategy and performance and emphasizing the identification of risks that could affect organizational objectives. Recent literature continued to support this integrated perspective, viewing ERM as a holistic approach that connects risk management with organizational decision-making, resilience, and performance (Akbaş, 2024; Otter & Kuttner, 2026).

The theory suggests that effective risk identification enables organizations to recognize potential threats early, evaluate possible consequences, and develop appropriate responses before risks adversely affect performance. This was particularly relevant to microfinance institutions because they faced credit, liquidity, operational, and market risks that could affect profitability and financial sustainability. Recent empirical evidence shows that risk management is associated with financial performance among MFIs, and that effective management of financial risks is important for institutional sustainability (Baltas, 2025; Molla & Kaur, 2025). However, ERM has been criticized because its implementation can be costly and complex, particularly for institutions with limited resources, and some emerging risks cannot be easily predicted or quantified. Nevertheless, the theory provided an appropriate foundation for this study because it explained how systematic risk identification practices could enable MFIs to minimize potential losses, improve decision-making, and ultimately enhance financial performance. It therefore supported the objective of determining the effect of risk identification practices on the financial performance of microfinance institutions in Nairobi County, Kenya.

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2.2 Empirical Review

2.2.1 Risk Identification Practice and Financial Performance

Al-Tamimi *et al*. (2022) examined risk management practices and the financial performance of commercial banks in the United Arab Emirates. The study analyzed key risk management components, including risk identification, using panel data from financial statements and survey data from risk management departments. Risk identification practices served as the independent variable, while financial performance was measured by return on assets and return on equity. The data were analyzed with multiple regression, and the findings showed that effective risk identification significantly improves financial performance by enabling early detection and mitigation of risks. Similarly, Alam *et al*. (2023) examined the relationship between risk management practices and firm performance across emerging markets. The study used secondary panel data from financial statements, measuring risk identification with risk disclosure indices and financial performance with profitability ratios. Using structural equation modeling, the study found that risk identification positively and significantly affects financial performance, particularly when integrated with other risk management processes. In addition, Gordon *et al*. (2021) examined enterprise risk management and firm performance in the United States using secondary data from publicly listed firms. They measured risk identification using ERM adoption indices, financial performance using return on assets, and analyzed the data using panel regression. The findings indicated that firms with structured risk-identification systems showed improved financial stability and overall performance.

Munene and Ngugi (2022) conducted a study across Sub-Saharan Africa examining portfolio risk and the sustainability of microfinance institutions. The study used panel data from MFIs across multiple countries, with portfolio-at-risk indicators used to proxy risk identification and financial sustainability as the dependent variable. The study used panel regression analysis and found that effective risk identification significantly reduces portfolio risk and enhances financial sustainability. Similarly, Tetteh *et al*. (2022) studied risk management practices and the financial performance of financial institutions in Ghana. The study used primary questionnaire data and secondary financial data, measuring risk identification through internal risk assessment systems and financial performance using profitability indicators. The data were analyzed using multiple regression, and the findings revealed that risk identification practices have a significant positive effect on financial performance. Furthermore, Mensah *et al*. (2023) conducted a study in West Africa using panel data from financial institutions to examine the relationship between risk management and firm performance. They measured risk identification using risk disclosure indices, financial performance using return on equity, and analyzed the data using the generalized method of moments (GMM). The findings indicated a positive and significant relationship between risk identification and financial performance.

Wanjiku *et al*. (2024) conducted a study in Kenya on risk management practices and the financial performance of microfinance institutions. The study used both primary data collected through structured questionnaires and secondary data from financial reports. Risk identification practices served as the independent variable, while financial performance was measured using profitability and portfolio quality indicators. The data were analyzed using descriptive statistics and regression analysis, and the findings indicated that effective risk identification practices significantly improve financial performance by reducing loan default rates and enhancing portfolio quality. Similarly, Muriuki and Njeru (2023) studied credit risk management and financial performance in Kenya using secondary data from audited financial statements. They measured risk identification through

credit appraisal and screening mechanisms and financial performance using return on assets. The regression analysis showed that strong risk identification practices significantly reduce non-performing loans and improve financial performance. In addition, Onyango *et al*. (2022) conducted a study in Kenya examining financial management practices and institutional performance using survey data and financial records. The study incorporated risk identification into financial control systems and measured financial performance using efficiency and profitability indicators. The data were analyzed using correlation and regression analyses, and the findings revealed that institutions with robust risk identification systems demonstrate better financial performance.

2.3 Conceptual Framework

The conceptual framework illustrated the relationship between risk identification practices and the financial performance of microfinance institutions in Nairobi County, Kenya. Risk identification practices formed the independent variable, while financial performance formed the dependent variable. The framework showed how effective identification of potential risks could enable MFIs to take timely corrective measures and, consequently, improve profitability, asset growth, loan portfolio performance,, and financial sustainability.

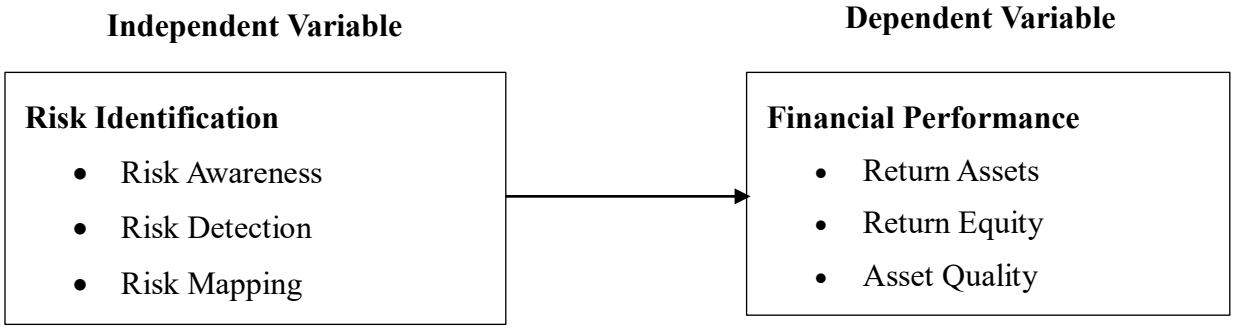


Figure 1: Conceptual Framework

3.0 Methodology

The study adopted a positivist research philosophy because it sought to objectively establish the effect of risk identification practices on the financial performance of microfinance institutions using measurable and quantifiable data. The study adopted a descriptive and correlational research design to describe existing risk identification practices and determine the relationship between risk identification practices and the financial performance of microfinance institutions in Nairobi County, Kenya. The study used a quantitative approach, enabling the researcher to collect numerical data and statistically test the relationship between the study variables. The target population comprised licensed microfinance institutions operating in Nairobi County, with the unit of analysis being the selected microfinance institutions and the unit of observation being managers, risk officers, credit officers, and finance officers knowledgeable about risk management and financial operations. The study used purposive sampling to select respondents with relevant information on risk identification practices and financial performance. Primary data were collected using structured questionnaires containing closed-ended items measured on a five-point Likert scale ranging from strongly disagree to agree strongly. The questionnaires were administered physically and/or electronically to the selected respondents.

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A pilot study was conducted among respondents from microfinance institutions that were not included in the final study to establish the reliability and clarity of the research instrument. Reliability was assessed using Cronbach's alpha, with a coefficient of 0.70 or higher considered acceptable. The research supervisor and experts in research methodology and risk management established content validity through review. The study also observed ethical requirements, including informed consent, voluntary participation, confidentiality, anonymity, and the use of collected information strictly for academic purposes. The researchers coded and analyzed the data using the Statistical Package for the Social Sciences (SPSS). Descriptive statistics, including frequencies, percentages, means, and standard deviations, were used to summarize the data. Inferential analyses used Pearson correlation and simple linear regression to examine the relationship and effect of risk identification practices on financial performance. The regression model was specified as:

$$Y = \beta 0 + \beta X + \varepsilon$$

Where:

Y = Financial Performance

B_0 = Constant

β = Regression coefficient of risk identification practices

X = Risk Identification Practices

ε = Error term

The hypothesis was tested at a 5% level of significance, where a p-value less than 0.05 led to rejection of the null hypothesis.

4.0 Findings

The study findings presented the results of the analysis on the effect of risk identification practices on the financial performance of microfinance institutions in Nairobi County, Kenya. The findings were based on data collected from the selected respondents and analyzed using descriptive and inferential statistics. Descriptive statistics summarized risk identification practices and financial performance, while Pearson correlation and regression analysis established the relationship and effect between the study variables. A total of 165 questionnaires were issued to the respondents selected from microfinance institutions in Nairobi County. Of these, 144 questionnaires were returned, representing a response rate of 87.3%.

4.1 Descriptive Statistics

Descriptive statistics summarized responses on risk identification practices and the financial performance of microfinance institutions in Nairobi County, Kenya. The analysis presented means and standard deviations for the study items, providing an overview of the extent to which institutions implemented risk identification practices and the observed level of financial performance.

4.1.1 Risk Identification Practice

Respondents indicated their level of agreement with statements on risk identification practice using a five-point Likert scale (1 = NA- 5 = VLE). Table 2 presents the results.

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Table 1: Descriptive Statistics for Risk Identification Practice

Statements	NA F (%)	SE F (%)	ME F (%)	LE F (%)	VLE F (%)	Mean	SD
The institution clearly understands potential risks affecting its operations.	6 (4.2%)	12 (8.3%)	25 (17.4%)	38 (26.4%)	63 (43.8%)	3.97	1.15
Employees are well informed about risks relevant to their roles.	9 (6.3%)	14 (9.7%)	21 (14.6%)	33 (22.9%)	67 (46.5%)	3.94	1.25
Risk awareness is regularly communicated across all departments.	7 (4.9%)	11 (7.6%)	23 (16.0%)	31 (21.5%)	72 (50.0%)	4.04	1.19
The institution has effective systems for detecting potential risks early.	5 (3.5%)	16 (11.1%)	26 (18.1%)	35 (24.3%)	62 (43.1%)	3.92	1.17
Emerging risks are identified before they significantly affect operations.	8 (5.6%)	13 (9.0%)	24 (16.7%)	30 (20.8%)	69 (47.9%)	3.97	1.23
The institution uses appropriate tools to detect financial and operational risks.	4 (2.8%)	18 (12.5%)	20 (13.9%)	32 (22.2%)	70 (48.6%)	4.01	1.18
The institution systematically identifies and categorizes different types of risks.	3 (2.1%)	10 (6.9%)	27 (18.8%)	66 (45.8%)	38 (26.4%)	3.88	0.95
Risk mapping processes are clearly documented and implemented.	6 (4.2%)	15 (10.4%)	22 (15.3%)	68 (47.2%)	33 (22.9%)	3.74	1.06
The institution prioritizes risks based on their potential impact.	2 (1.4%)	17 (11.8%)	23 (16.0%)	31 (21.5%)	71 (49.3%)	4.06	1.12
Overall						**3.95**	**1.15**

Table 2 indicates that risk identification practices were generally implemented, as shown by the overall mean of 3.95 and standard deviation of 1.15. The findings suggest that microfinance institutions generally had established mechanisms to identify, communicate, and prioritize risks. The statement that the institution prioritized risks based on their potential impact recorded the highest mean (4.06; SD = 1.12). A total of 49.3% of respondents indicated a very large extent, while 21.5% indicated a large extent. This suggests that prioritizing risks by potential impact was a well-established risk identification practice. Risk awareness being regularly communicated across all departments recorded a mean of 4.04 (SD = 1.19). Half of the respondents (50.0%) indicated a very large extent, while 21.5% indicated a large extent. This indicates that risk awareness was widely communicated across the institutions. The use of appropriate tools to detect financial and operational risks recorded a mean of 4.01 (SD = 1.18). A total of 48.6% of respondents indicated a very large extent, and 22.2% indicated a large extent. This suggests that institutions generally used appropriate mechanisms to detect financial and operational risks.

Institutions with a clear understanding of potential risks affecting their operations recorded a mean of 3.97 (SD = 1.15). The findings show that 43.8% of respondents indicated a very large extent, while 26.4% indicated a large extent. This demonstrates that most respondents perceived their

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institutions as having a clear understanding of potential operational risks. Similarly, identifying emerging risks before they significantly affected operations had a mean of 3.97 (SD = 1.23). A total of 47.9% of respondents indicated a very large extent and 20.8% indicated a large extent. This suggests that institutions generally had mechanisms to identify emerging risks before they caused significant operational effects. Employees being well informed about risks relevant to their roles recorded a mean of 3.94 (SD = 1.25). The largest proportion (46.5%) indicated a very large extent, while 22.9% indicated a large extent. This suggests that employees were generally informed about the risks associated with their responsibilities. The effectiveness of systems for detecting potential risks early recorded a mean of 3.92 (SD = 1.17). A combined 67.4% of respondents indicated either a large or very large extent. This suggests that institutions generally had early risk detection systems in place.

The systematic identification and categorization of different types of risks recorded a mean of 3.88 (SD = 0.95). The findings indicate that 45.8% of respondents reported a large extent and 26.4% reported a very large extent. This suggests that systematic risk categorization was generally practiced, although its mean was comparatively lower than several other risk identification practices. Finally, risk mapping processes being clearly documented and implemented recorded the lowest mean of 3.74 (SD = 1.06). Although 47.2% of respondents indicated a large extent and 22.9% indicated a very large extent, the result suggests that documentation and implementation of risk mapping processes were comparatively less pronounced. Overall, risk identification practice recorded a mean of 3.95 and a standard deviation of 1.15. The overall mean indicates that microfinance institutions implemented risk identification practices to a relatively large extent. The standard deviation indicates moderate variation in respondents' assessments. Overall, the findings suggest that risk prioritization, risk awareness communication, use of risk detection tools, and early identification of emerging risks were relatively well established, while documentation and implementation of risk mapping processes could be further strengthened.

4.2 Correlation Analysis

Pearson correlation analysis was conducted to establish the nature and strength of the relationship between risk identification practices and the financial performance of microfinance institutions in Nairobi County, Kenya. The analysis determined whether changes in risk identification practices were associated with corresponding changes in financial performance. The results were interpreted using the correlation coefficient (r) and the significance level (p-value), with statistical significance assessed at the 1% level.

Table 2: Correlation Matrix

Variables	Risk Identification Practices	Financial Performance
Risk Identification Practices	1.000	0.638**
Financial Performance	0.638**	1.000
Sig. (2-tailed)	—	<0.01
N	**144**	**144**

The findings indicated that risk identification practices had a positive and statistically significant relationship with the financial performance of microfinance institutions in Nairobi County, Kenya ($r = 0.638$, $p < 0.01$). The correlation coefficient of 0.638 indicated a strong positive association, suggesting that microfinance institutions with more established and effective risk identification practices tended to report higher financial performance. The statistically significant p-value of less than 0.01 indicated that the observed relationship was unlikely to have occurred by chance.

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Therefore, the findings provided empirical support for a significant positive relationship between risk identification practices and financial performance among microfinance institutions.

4.3 Regression Analysis

A regression analysis was conducted to establish the extent to which risk identification practices explained variations in the financial performance of microfinance institutions in Nairobi County, Kenya. The model summary presented the strength of the relationship and the proportion of variation in financial performance explained by risk identification practices.

Table 3: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.638	0.407	0.403	0.30

The results showed that risk identification practices had a strong positive relationship with financial performance, as indicated by an R-value of 0.638. The R-squared value of 0.407 indicated that risk identification practices explained 40.7% of the variation in financial performance. The adjusted R Square of 0.403 indicated that the model explained 40.3% of the variation after adjustment for sample size, while the remaining 59.7% was explained by other factors not included in the model.

An analysis of variance (ANOVA) was conducted to establish whether the regression model significantly explained variations in the financial performance of microfinance institutions in Nairobi County, Kenya. The analysis assessed the overall significance of the regression model and determined whether risk identification practices significantly predicted financial performance.

Table 4: Analysis of Variance

Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	76.77	1	76.77	97.21	<0.001
Residual	112.35	142	0.79		
Total	189.12	143			

Table 4 shows that the regression model was statistically significant, $F(1, 142) = 97.21$, $p < 0.001$. This indicated that risk Identification practices significantly explained variations in the financial performance of microfinance institutions in Nairobi County. The significant F-statistic showed that the regression model meaningfully explained the relationship between risk identification practices and financial performance. Because the significance value was below the 0.05 threshold, the study rejected the null hypothesis that risk identification practices had no significant effect on financial performance. The findings therefore suggested that improvements in risk identification practices were associated with significant improvements in microfinance institutions' financial performance.

A regression coefficient analysis was conducted to determine the direction, magnitude, and statistical significance of the effect of risk identification practices on the financial performance of microfinance institutions in Nairobi County, Kenya. The analysis provided the regression coefficient, standard error, standardized coefficient, t-value, and significance level for the predictor variable.

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Table 5: Regression Coefficients

Model	Unstandardized Coefficients B	Std. Error	Standardized Coefficients Beta	t	Sig.
(Constant)	3.089	0.191	—	16.173	<0.001
Risk Identification Practices	0.218	0.075	0.638	2.907	0.004

Table 5 shows that risk identification practices had a positive and statistically significant effect on financial performance (β = 0.218, t = 2.907, p = 0.004). This implied that a one-unit increase in risk identification practices was associated with a 0.218-unit increase in financial performance, holding other factors constant. The positive coefficient indicated that strengthening practices such as risk awareness, early risk detection, risk categorization, risk mapping, and risk prioritization was associated with improved financial performance. The significance value of 0.004 was below the 0.05 threshold, indicating a statistically significant effect. The standardized beta coefficient of 0.638 further indicated a strong positive relationship between risk identification practices and financial performance. Therefore, the findings provided sufficient evidence to reject the null hypothesis and conclude that risk identification practices significantly influenced the financial performance of microfinance institutions in Nairobi County, Kenya.

Regression equation:

Y = 3.089 + 0.218X

Where:

Y = Financial Performance

3.089 = Constant

0.218 = Regression coefficient of Risk Identification Practices

X = Risk Identification Practices

4.4 Hypothesis Test Results

The hypothesis was tested to establish whether risk identification practices had a statistically significant effect on the financial performance of microfinance institutions in Nairobi County, Kenya. The decision was based on the regression coefficient and its corresponding significance value at the 5% level.

Risk identification practices had a positive and statistically significant effect on financial performance (β = 0.218, t = 2.907, p = 0.004). Since the p-value of 0.004 was less than the 0.05 level of significance, the null hypothesis was rejected. The study therefore concluded that risk identification practices significantly affected the financial performance of microfinance institutions in Nairobi County, Kenya. The positive coefficient further indicated that improvements in risk identification practices were associated with improvements in financial performance. These findings suggested that practices such as risk awareness, early detection of emerging risks, systematic risk categorization, risk mapping, and risk prioritization were important in supporting better financial outcomes among microfinance institutions.

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5.0 Summary of Findings

The study found that risk identification practices were generally well implemented among microfinance institutions in Nairobi County, with an overall mean of 3.95 and a standard deviation of 1.15. Risk prioritization recorded the highest mean of 4.06, followed by regular communication of risk awareness across departments (4.04) and the use of appropriate risk-detection tools (4.01). However, documented risk mapping had the lowest mean (3.74), indicating an area that required further strengthening. The inferential findings showed a strong, positive, and statistically significant relationship between risk identification practices and financial performance ($r = 0.638$, $p < 0.01$). Regression analysis showed that risk identification practices explained 40.7% of the variation in financial performance ($R^2 = 0.407$). The regression results further indicated a positive and statistically significant effect of risk identification practices on financial performance ($\beta = 0.218$, $t = 2.907$, $p = 0.004$). The ANOVA results confirmed that the regression model was statistically significant, $F(1, 142) = 97.21$, $p < 0.001$. Consequently, the null hypothesis was rejected, establishing that risk identification practices significantly influenced the financial performance of microfinance institutions in Nairobi County.

5.1 Conclusion

The study concluded that risk identification practices were important in enhancing the financial performance of microfinance institutions in Nairobi County, Kenya. The positive and significant relationship the study established indicated that institutions with stronger risk identification practices tended to achieve better financial performance. Effective risk awareness, early detection of potential and emerging risks, systematic risk categorization, risk mapping, and prioritization enabled institutions to identify threats early and take appropriate corrective measures. The study therefore concluded that strengthening risk identification practices could improve profitability, loan portfolio quality, asset growth, and the overall financial sustainability of microfinance institutions.

6.0 Recommendations

Policymakers and financial sector regulatory agencies, particularly the Central Bank of Kenya, should strengthen policies and guidelines that encourage microfinance institutions to establish effective risk identification systems. They should place greater emphasis on early-warning mechanisms, systematic risk mapping, regular risk reviews, and prioritizing emerging risks. Regulatory agencies should also strengthen monitoring and provide capacity-building programmes on risk identification and incorporate clear risk identification requirements into the supervision and regulatory frameworks for microfinance institutions.

Management of microfinance institutions should strengthen risk identification practices by regularly assessing potential credit, liquidity, operational and market risks. Institutions should invest in appropriate risk-detection tools, improve employee awareness, and ensure that identified risks are systematically categorized, documented, and communicated across departments. Management should also strengthen risk mapping processes, which recorded the lowest mean of 3.74, and ensure that risks are prioritized according to their potential impact. Institutions should regularly review risk identification systems to respond promptly to emerging risks and improve profitability, loan portfolio quality, and overall financial performance.

Future studies should examine other dimensions of risk management, including risk assessment, risk mitigation, risk monitoring and risk control, to establish their individual effects on the financial

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performance of microfinance institutions. Further research should also cover microfinance institutions in other counties in Kenya and other financial institutions to determine whether the findings vary across geographical and institutional contexts. Future researchers could also employ longitudinal research designs and qualitative approaches to provide deeper insights into how risk identification practices influence financial performance over time.

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