

Dynamic Capabilities and Performance in the Context of Microfinance Institutions in Kenya: An Exploratory Study

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Abstract—Micro Finance Institutions in Kenya contribute greatly to the economic growth. They offer financial services to the poor in the society and people who can't afford commercial bank services. Licensed MFIs in overall recorded a 7% decline in assets as at 31 December 2017 contrary to a 5% growth that was witnessed in 2016. Repayment default, market mean sustainability, government regulations, financial sustainability policies, and funding have been the major challenges faced by MFIs. The study will thus have six objectives; to examine the effect of absorptive capability on performance of MFI in Kenya, ; to examine the effect of adaptive capability on performance of licensed MFIs in Kenya, ; to examine the effect of innovative capability on performance of MFI in Kenya, ; to examine the effect of networking capability on performance of MFI in Kenya, to examine the mediating effect of strategic choice on the relationship between dynamic capabilities and performance of MFI in Kenya and to examine the moderating effect of business regulatory environment on the relationship between dynamic capabilities and performance of licensed MFIs in Kenya. The study will be based on various theories; resource based view, dynamic capabilities view, theory of strategic choice, institutional theory and balanced score card. Resource based view will be the main theory to anchor the study. Empirical studies on the various variables will be reviewed. The study will adopt positivist approach and combined descriptive and explanatory cross sectional research design will be used. The target population will comprise 13 licensed MFIs in Kenya between the year 2017 and 2018 with four functional areas from each. A census of the licensed MFIs will be done to analyse the data. Primary data will be collected using semi-structured self-administered questionnaires for both quantitative and qualitative data. Secondary data will be collected from AMFI published reports, financial reports published by MFIs and Central Bank of Kenya reports on MFIs between 2017- 2018. Face, content and construct validity will be ensured through expert opinions and pilot testing. Reliability test will be through use of Cronbach's alpha score at the level of 0.7. Descriptive statistics includes mean scores, standard deviations, percentages, and frequency distribution will be used to analyse the data. Mutiple regression will further be done and coefficient of determination (R²) will be used to establish the statistical significance of the regression models. Significance level of 0.05 will be used.

Keywords— Business Regulatory Environment, Dynamic Capabilities, Micro Finance Institution, Performance, Strategic Choice.

I. INTRODUCTION

Micro Finance Institutions (MFIs) supply banking services to supposedly poor families and micro enterprises [1]. Micro finance lending started long time ago in the 1700s in Ireland [2]. It later increased in 1970 when governments realized that injecting capital through the commercial banks was not the only cure for poverty. These institutions need to make use of their inherent capabilities so as to sustain their performance.

The United Nations (UN) has had a great role in support of microcredit institutions. Through the UN Year of microcredit, with the aim of providing greater access to credit, savings, insurance, transfer remittances and other financial services for poor and low-income households so as to move towards more secure livelihoods and prosperous futures that is aimed at reducing poverty. In 2006, Muhammad Yunus and Grameen bank were awarded Nobel Peace Prize for their contribution in reducing poverty through MFIs [3]. [4] Lopatta and Tchikov showed that success in the performance of MFIs significantly influences economic development. Further, research by [5] Ahmed and Hassan on MFIs in Bangladesh found out that MFIs contribute greatly to the national economy despite various achievements and challenges. MFIs have greatly increased in Africa due to unsatisfied demand for financial services [6]. The Economic Outlook for 2017 focused a growth in micro and SME finance markets by 10-15%. In Sub Saharan Africa the growth was estimated to be 5-10% due to the prevailing environmental conditions. The major problems facing Micro finance institutions are; risk analysis, environmental adjustment, customization of methodology and guarantees and customer support [7].

Guinea and Tanzania have MFIs that have increased in number yet they face the challenge of good performance through institutional constraints [6]. MFIs in Nigeria are faced with the problem of credit portfolio, regulation and sustainability [8]. The credit portfolio problem affects the MFIs viability while inability to be self-sufficient affects the MFIs sustainability.

The forecast for Kenya economic growth was 6.1% growth rate with most MFIs being financially unstable and having inadequate regulations [9]. These challenges can be addressed by having good strategic decisions on how to effectively tap on the dynamic capabilities held by MFIs. MFIs in Kenya provide micro finance services to the lower pyramid in the society [10]. MFIs in Kenya are under the Central Bank of Kenya (CBK) and they began in 1990. The Association for Micro-finance Institutions (AMFI) a member-based organization was later established and registered in 1999 under the societies Act, with the aim of building the capacity of the Kenyan Micro finance Industry [11]. AMFI has 60 fully paid up members and the members are divided into three; micro finance banks, credit only MFIs and Savings and Credit Cooperative (SACCO). This study will focus on the licensed micro finance banks [11].

There are 13 licensed MFIs in Kenya which are classified into three peer groups; large, medium and small. A MFI is classified as large if it has a market share of 5% and above; medium if it has a market share of between 1% and 5% and small if its market share is less than 1%. Based on the classification there were 3 large, 3 medium and 7 small MFIs as at 31 December, 2017 and this study will focus on them between the year 2017 and 2018 (Appendix II). The performance of MFIs in Kenya has been declining. MFIs in Kenya recorded a 7% decline in assets as at 31 December 2017 contrary to a 5% growth that was witnessed in 2016 [12]. Selected focus on growth alone of MFIs has affected performance of MFIs [13].

Eisenhardt and Martin (2000) found out that dynamic capabilities help in designing value creating strategies that enhance the performance of the firm. Most MFIs have not yet been established and thus they do not benefit more from dynamic capabilities [14]. MFIs can improve their performance if they effectively utilize dynamic capabilities. Dynamic Capabilities (DC) allow firms to create new products and processes and address changes in the market thus improving their performance [15] [16] [17] [18] [19]. The DC are idiosyncratic and help institutions in meeting the challenges brought about by turbulence in the market environment [20] [21].

The DC are divided into various sub-capabilities; adaptive, absorptive, innovative and networking capabilities. These sub capabilities have been identified by various scholars using different names like sensing, integration or building [22] [23] [24] [25] [26] [14] [27] [28] [29] [30] [31]. The various sub capabilities have a direct or indirect relationship with performance.

MFIs have to survive in the turbulent environment by using its capabilities well [20] [21]. This calls for appropriate strategic choices by the institutions top management so as to sustain the performance through competitive advantage. Only firms that are able to create and sustain competitive advantage are the only ones that survive [24] [32]. The essence of firms is to stay lucrative and solvent and this can only be achieved by the firm achieving its internal and external objectives [33]. To achieve these objectives the strategic choice process of strategic intent, strategic analysis, strategic options and strategic decision is paramount [34] [35] [36] [37] [38] [39].

Dynamic capabilities provide the firms's management with a number of alternative options and a foundation for strategic choice [25] [39]. Dichter and Harper further opined that MFIs need to rethink some policies since MFIs are not a panacea and that they may be damaging the intended customers [40]. Superior performance in institutions is mostly achieved through better and timely strategies that are achieved through making strategic choices by institutions top management team [41] [38].

The conduct of MFIs is regulated by the government through Central Bank of Kenya [12]. The business regulatory environment includes the guidelines and means used to administer them. It encompasses all applicable legislative documents (acts, regulations, annexes) and designates the agency or body accountable for administering the framework. Research by Allaire, Ashta, Attuel-Mendes, and Krishnaswamy [42] found out that establishment of specific legal framework for MFIs in Morocco has helped improve their performance.

Firms response to changes in the business regulatory environment is determined by the dynamic capabilities the firm has [14]. Regulated MFIs offer more client trust [43]. Most MFIs are affected by changes in the business regulatory environment. The business regulatory environment indicators include organisational and national culture, government laws and regulations, prudential and non-prudential guidelines and industry self-regulations [44].

1.1 Performance

Connolly, Conlon and Deustch, [45] argued that satisfaction of stakeholders is the measure of firm performance. Muchemi [41] adds that, firm performance is efficiency and effectiveness in utilising resources and the attainment of firm goals. Most MFIs currently suffer from credit risk (Mohammed & Wobe 2019) and this has led to under performance and closure of MFIs. Firm performance can either be financial or strategic performance. Financial perspective includes profitability, growth and market value indicators.

Strategic performance is measured by various factors; benefits management, portfolio management, risk management, critical success factors and program management. They help in detecting any variations from the expected and having action plans for such variations [46]. These factors are not easily tangible, quantifiable and realizable. Portfolio quality, efficiency, productivity, financial management and profitability were the main measures of MFI performance [44]. These were observed by Helms [47], as tools for managing MFIs and as a requirement for sustainability also.

Portfolio quality is a key component of analysis, since the biggest source of risk for any financial institution exists in its loan portfolio. Stauffenberg, Jansson, Kenyon and Badiola [48], argued that loan portfolio is by far a microfinance's biggest asset that are typically not backed by bankable collateral, the quality of the portfolio is absolutely crucial. Portfolio quality and associated risks are operationalized by portfolio at risks, write offs, provision expenses and risk coverage [44]. The measure of portfolio quality in the microfinance industry is by portion of the loan portfolio in

arrear as a percentage of the total portfolio, also called Portfolio at Risk (PAR).

Financial management and profitability indicator ensures that MFIs have liquid cash to offer loans to borrowers and repay loans to its creditors funding expense, cost of funds and debt/equity are the indicators for financial management [44]. Profits motivate microfinance institutions to grow. Return on Equity (ROE), Return on Assets (ROA) and portfolio yield are the indicators of profitability. ROA indicates the ability of the management to acquire deposits at a reasonable cost and invest them in profitable investments [49]. The equity of the firm is the investment by shareholders [50].

Gunday, Ulusoy, Kilic and Alpkın, [51] study on effects of innovation types on performance of SMEs used ROA, cash flows, profitability and return on sales as measures of firm financial performance. Based on the several studies on MFIs performance, the study will adopt portfolio quality, efficiency and productivity, financial management and profitability as the key performance indicators that will be analysed.

1.2 Dynamic capabilities

The concept of dynamic capabilities has its foundation in resource based view which emphasizes on firms distinct resources that lead to its competitive advantage [15]. Dynamic capabilities help in designing value creating strategies that enhance the performance of the firm by integrating, building and reconfiguring the internal and external competencies in the ever changing environment [15] [19] [22] [23] [52].

Dynamic capabilities have been disaggregated into three; sense and shape opportunities and threats, seize opportunities and reconfiguration of firm intangible and tangible assets. This has been the basic foundation of dynamic capabilities studies [15] [53] [54]. Several studies have used one, two or three indicators of dynamic capabilities; sensing, seizing and reconfiguration [55] [56] [57] while others have four indicators; sensing, seizing and reconfiguration and innovation [32]. Helfat and Peteraf [58] espoused that dynamic capabilities have been one of the most significant and challenging question within the domain of strategy; “Holy Grail” of strategic management. Karagouni, Protogerou and Calaghiro [59] came up with a new dynamic capability dimension of autotelic capability. This dimension has not been fully explored. Dannneels [60] echoed this lack of generally accepted approaches on measuring dynamic capabilities key constructs.

On the contrary other researchers found out that dynamic capabilities do not automatically lead to improved performance [61][62] [63]. The influence of the different sub capabilities of dynamic capabilities have varied effects on performance as well. This leads to inconsistencies. Myriad of studies have found out that a positive relationship exists between absorptive capability and performance among industrial firms and SMEs [64] [65] [66]. Adaptive capabilities are also related to firm performance by facilitating strategic flexibility [67].

Innovative capabilities help institutions in maintaining the competitive advantage and focus on the customers [68]. Innovation capabilities have been related to performance of

firms [69] [70] [71]. Innovation capabilities are divided into four indicators; product, process, organizational and market innovation [72] [73]. Networking capability facilitates how the institution can work in union with other stakeholders in a synchronized manner through inter relations to meet the changing environmental demands. This involves relationship with suppliers, buyers and government institutions. There is minimal research on networking capability among firms [74] [75] [76]. The study will use absorptive capability, adaptive capability, innovative capability and networking capability as the indicators of dynamic capabilities within MFIs as echoed by Kihara [77].

1.3 Strategic Choice

Strategic management is about positioning of the firm by making strategic choices that will relate the firm to the environment and be assured of survival and continued success [78] [79]. The works of Andrew [80] brought about the concept that capabilities shape strategy by offering a framework. The strategic choice involves making choices that are in line with the firm overall performance and one that offers maximum utility to the firm. When firms use the Confucian concept of harmony; knowledge, as their strategic intent they become ethical and successful [81].

Strategic choices provide the road map or plan for the firm towards attainment of its objectives. Decision-making process involves the continuous process of gathering intelligence, setting direction, option identification, strategic choice and implementation [82]. Studies by Krzakiewicz and Cyfert [83] found out that strategic choice-making is more focused on the interrelationships between strategy and the firm’s internal environment.

Strategic choice making process involves utilization of dynamic capabilities to have core competences that form basis for competitive advantage. This process is a continuum [22] [23] [84]. Strategic choice process can thus be described in terms of the whole process through which a decision is taken to choose a particular option or course of action from various alternatives using diverse methods and in consideration of the internal and external environments.

A valid course of action to must meet the; Feasibility, Acceptability, Completeness, Exclusivity and Suitability (FACES) criteria [85]. This has been the basis for strategic intuition in the military and it’s applicable in firm administration. It involves an analysis of the adversary’s Centers of Gravity (COG), critical capability, critical requirement and critical vulnerability so as to be able to unlock it while protecting its own COG using the Strange Model and Godzilla Methodology [38] [44] [86] [87] [88] [89] [90].

Tony [87] proposed a five point criteria to guide on how the choice is arrived at so as to strike the balance found missing from previous literature and practice. The five point criteria (strategic attractiveness, financial attractiveness, implementation difficulty, uncertainty and risk) guided on how strategic choice was finally arrived at. This criteria mostly addressed the various aspects that managers will look at so as to make the viable choice. This study will analyse the strategic

choice process of intent, analysis, option generation and choice selection as indicators of strategic choice variable.

1.4 Business Regulatory Environment

Firms do not operate in a vacuum and thus the environment within which they operate in can affect their overall performance. The business regulatory environment includes the guidelines and means used to administer them [91]. Establishment of specific legal framework for MFIs in Morocco has helped improve the growth of MFIs [42] [92]. How firms respond to changes in the business regulatory environment is determined by the dynamic capabilities the firm has [14]. Most MFIs are affected by changes in the business regulatory environment [44]. Regulated MFIs offer more client trust [43]. The study intends to use business regulatory environment variable as a moderating variable of the relationship between dynamic capabilities and performance of MFIs.

The business regulatory environment indicators include organisational and national culture, government laws and regulations, prudential and non-prudential guidelines and industry self-regulations [12] [93] [94] [95] [96]. The study will adopt organisational and national culture, government laws and regulations, prudential and non-prudential guidelines and industry self-regulations as business regulatory environment indicators.

1.5 Micro Finance Institutions in Kenya

MFIs in Kenya provide micro finance services to the lower pyramid in the society [10]. Hartungi [97] espoused that micro finance includes the provision of financial intermediation services which include savings, credit fund transfers, insurance and pension remittances. MFIs in Kenya began in 1990 under the CBK and they are under the Association for Micro-finance Institutions (AMFI) which was established and registered in 1999 under the societies Act, with the aim of building the capacity of the Kenyan Micro finance Industry [11].

The Micro Finance Act was passed in 2006 and Micro Finance (Deposit Taking Institutions) regulations in 2008. These legislations govern the conduct of MFIs in Kenya [11]. Among the 60 fully paid up AMFI members, there are only 13 licensed MFIs in Kenya as at 2017 [12]. The proposed study will focus on the 13 licensed MFIs in Kenya between 2017 and 2018.

The performance of micro finance institutions has been declining due to repayment default, market mean sustainability, government regulations and funding [13] [98]. The number of people with access to financial services from MFIs is minimal due to lack of awareness on MFIs by the potential customers [12]. Armendáriz and Szafarz [99] found out that MFIs suffer from mission drift challenge in that they deviate from their initial mission of alleviating poverty.

1.6 Statement of the problem

MFIs in Kenya have declined in their overall performance with a 7% decline in assets as at 31 December 2017 contrary to a 5% growth that was witnessed in 2016 [12]. Selected focus

on growth alone of MFIs has affected performance of MFIs [98]. Repayment default, market mean sustainability, government regulations and funding have been the main challenges affecting MFIs [13] [98]. Further, deviation from initial mission of alleviating poverty has been a problem [99]. This calls for research on the performance of MFIs so as to attain sustainability and be able to survive in the increased competition in the banking sector.

Minimal research has been done on the association of dynamic capabilities and performance of in the context of MFIs. Most of the research has been on macro finance institutions, technological industries, manufacturing, pharmaceutical, aviation and multinational enterprises. Most studies on dynamic capabilities have as well been conducted in American, European or Asian countries. This brings about a contextual gap. Therefore, adopting this construct in Kenya, a third world country in Africa will provide insights on the effectiveness of integrating the variables; dynamic capabilities, strategic choice, business regulatory environment and firm performance in a single research.

Most MFIs have not yet been established and thus they do not benefit more from dynamic capabilities [23]. MFIs can improve their performance if they effectively utilize dynamic capabilities. This gap offers more need for research on MFIs in Kenya since minimal research has been done prior on dynamic capabilities among MFIs in Kenya, thus need to address this gap.

There have been methodological flaws, consensus, fragmentation and inconsistencies on the conceptualization of the concepts of dynamic capabilities [23] [24] [14] [59] [100] [101]. Some researchers have used one, two or three sub capabilities of dynamic capabilities while others have used four and the recent introduction of autotelic capabilities as well. This lack of generally accepted approaches on measuring dynamic capabilities key constructs makes it important to research more and bring clarity on the conceptualization of the concepts of dynamic capabilities.

Teece [55] postulated that management's ability to develop and refine business models is a core micro foundation of dynamic capabilities. This makes the strategic choice variable to be dependent on dynamic capabilities. Strategic choice has mostly been used as a mediating variable on the relationship between management team diversity and firm performance [101] [38]. It will be desirable to have it as a mediating variable between dynamic capabilities and firm performance so as to enrich the strategic management academic knowledge since strategic choice has had an impact on firm performance and dynamic capability is linked to it.

Moreover, Rehman and Saeed [63] on the research on dynamic capabilities relationship with performance found out that the direct relationship between dynamic capabilities and performance was insignificant. This inconsistency brings about a research gap that needs an insightful research so as to enable strategic managers gain more from the dynamic capabilities elements.

Minimal research has been done with business regulatory environment as a moderator between dynamic capabilities and

firm performance. Research by Mbogo [94] on factors influencing product innovation of MFIs in Kenya found out that legal environment was one of the factors that had great importance in influencing MFIs innovation. This research will provide more information on the moderating effect of business regulatory environment on the relationship between dynamic capabilities and firm performance.

1.7 Objectives of the study

The study will have both general and specific objectives that it will seek to achieve.

1.7.1 General Objective

The general objective of the proposed study will be to establish the effect of dynamic capabilities on performance of MFI in Kenya.

II. LITERATURE AND REVIEW

2.1 Theoretical Review

Resource Based View, Dynamic Capabilities, Theory of strategic choice, Institutional theory and Balanced Score Card (BSC) will be reviewed into detail and how they relate to the three constructs of the study.

2.1.1 Resource Based View

Edith Penrose is the main proponent of the resource based view. The theory has had improvements from other scholars like Barney, Lippman, Rumelt, Wernerfelt and Teece to name a few who have made great advancements to this theory [15] [16][19].

She emphasized on the constructs of firm's resources and dynamic capabilities as the fundamental determinants of competitive advantage and performance. Resources and capabilities as primary drivers for a firm's sustained competitive advantage. The resource-based view to firm strategy portrays a firm as a collection of tangible and intangible assets, resources or competencies which are tied to the firm and are difficult for others to imitate.

Resources are key for any organisational growth. Resources include physical, organizational, and human resources available to management. The Resource Based View (RBV) theory is based on four critical assumptions; that resources must be heterogeneous, immobile, inimitable and non-substitutable. Heterogeneity means that the skills, capabilities and other resources that organizations possess differ from one firm to another and immobility means that resources are not mobile and do not move from firm to another, at least in short-run. The resources must be valuable in a way that it delivers value to the firm and rare so as to deliver a unique strategy compared to other firms in the industry. Moreover, resources need to be inimitable in that they should not be imitated by other competing firms in the industry [103]. These characteristics bring about competitive advantage which is key for survival.

Resource based view theory only considers the internal factors and forgets about the external factors which play a big

part towards the success of the firm. A firm performance is mostly measured on the basis of the external factors like customers and other stakeholders who are seen as more important for firm growth. The RBV theory links corporate responsibility performance as a stimulus to the development of intangibles; innovation, human capital, reputation, and culture [104] which results in the improvement of corporate financial performance. The improvement in financial performance leads to firm growth. The strategic managers make these decisions or strategic choices which affect the operating levels within the firm and overall firm performance.

The RBV will be used in anchoring the dynamic capabilities; absorptive, adaptive, innovative and networking capabilities since they are part of the firm resources in the realm of MFIs in Kenya. Resources should be valuable, rare, non-imitable and non-substitutable (VRIN).

2.1.2 Dynamic Capabilities View

The dynamic capabilities theory borrows from resource based view. Penrose found out that firms competitive advantage is based on firm-specific resources. This was the basis for inspiration for other scholars to come up with dynamic capabilities theory. Teece [22] proposed that dynamic capabilities reflect an organization's ability to achieve new and innovative forms of competitive advantage despite path dependencies and core rigidities in the firm's organizational and technical processes. Studies by Narayannan, Colwell and Douglas [105] found out that dynamic capabilities are the cornerstone of competitiveness and drivers of adaptability and innovativeness.

Ambrosini, Bowman, and Collier [103], found out that dynamic capabilities are divided into three levels; incremental, renewing and regenerative dynamic capabilities. Incremental dynamic capabilities are concerned with the continuous improvement of the firm's resource base while the renewing dynamic capabilities refresh, adapt and augment the resource base. Regenerative dynamic capabilities impact on firms current set of dynamic capabilities; these change the way the firm changes its resource base. Regenerative dynamic capabilities either come from inside the firm or enter the firm from outside, through changes in leadership or the intervention of external change agents.

Wang and Ahmed [106] postulated that dynamic capabilities are a firm's behavioral orientation constantly to integrate, reconfigure, renew and recreate its resources and capabilities and, most importantly, upgrade and reconstruct its core capabilities in response to the changing environment to attain and sustain competitive advantage within the industry. The main aim of dynamic capabilities is coming up with a sustainable competitive advantage. This as well requires good strategic decisions. The competitive advantage leads to improved firm performance. This is supported by Cepeda and Vera [107] who stated that firms which have dynamic capability will perform well.

The dynamic capabilities view thus focuses on enabling firms to respond to changes in a dynamic environment which involves generating, developing and accumulating firm's

resources, as inputs into the firm's value chain for sustainable advantage. This study will thus be anchored on the dynamic capabilities view as well so as to expound on the independent variable.

2.1.3 Theory of Strategic Choice

The theory is traced to studies in organization theory by John Child [108]. The theory describes how leaders influence an organization by making choices in a dynamic process. It emphasizes why the agency of individuals and groups within organizations make choices sometimes serving their own interests that dynamically influence the development of those institutions.

Strategic choice perspective originally advanced as a corrective to the view that the way in which organizations are designed and structured is determined by their operational contingencies. This view overlooked the way in which the leaders of organizations were able in practice to influence organizational forms to suit their own preferences. It drew attention to the active role of leading groups who had the power to influence the structures of their organizations through an essentially political process [108].

The strategic choice perspective considered the deterministic view to be inadequate because of its failure to give due attention to the agency of choice by those who have the power to direct the organization. In advancing this logic, the theory offered a description on the construct of strategic choice, the manner in which the choice is exercised which requires understanding of the nature of agency and choice [107]. The construct of strategic choice was defined as the process whereby power holders within organizations decide upon courses of strategic action. This description extended to include focus on the environment within which the organization is operating to the standards of performance against which the pressure of economic constraints has to be evaluated and to the design of the organization structure itself because it appreciated the reality that strategic choices are made through initiatives within the network of internal and external organizational relationships through pro-action as well as reaction [108]. In such a setting, effective strategic choice requires the exercise of power and is therefore an essentially political phenomenon.

Exercise of strategic choice by organizational decision makers was defined to refer to a process in which the first stage is their evaluation of the organization's position, the expectations placed on it by external resource, the trend of the relevant external events, the organization's recent performance, and how comfortable the decision makers are with its internal configurations. The theory argues that the decision makers' prior values, experience and training are assumed to colour this evaluation in some degree. The evaluation phase is followed by choice of objectives which is reflected in strategic actions decided on. This theory will be used to anchor the strategic choice variable in the realm of MFI.

2.1.4 Institutional Theory

The key proponents of institutional theory are Meyer and Rowan. Meyer, Rowan and DiMaggio[108], argued that

institutional theory is concerned with how firms ensure legitimacy in their existence and operations by conforming to rules, regulations and policies in the environment they operate in. Legitimacy is drawn from the rules or laws enacted by the governments, law courts, professional bodies, scripts and other cultural practices exert conformance pressures [108]. They further propagated the concept of isomorphism, whereby firms operate in tandem with laid down norms.

Institutional theory has evolved over time. There are three main types of institutions: regulatory, normative and cognitive. The regulatory pillar gave incentive and sanction to firms and individuals to regulate their actions [108]. In contrast, the normative and cognitive pillars were socially constructed over time and came to be perceived as objective and external to the actors: not as man-made but a natural and factual order [108]. The social construct within firms has led to variation in interpretations and thus differences among the strategic managers. In addition argued that institutional theory considers the process by which structures, including schemes, rules, norms and routines, become established as authoritative guidelines for social behaviour. The firm as a social institution is guided by regulations and guidelines [108].

Institutional theory shows that firm's behaviours are reactions to market and institutional pressures as well [110]. Institutional pressures come from external agencies like professional bodies, government, regulation bodies and other firms in the industry among others. These institutional pressures are further affected by economic dynamics and nature of decision making by the strategic managers. To ensure legitimacy in the eyes of external stakeholders, firms change towards practices that are in tandem with the law despite them not being efficient. Campbell [111] suggested that the behaviour of firms in a socially responsible way is shaped by institutional theory. This helps in guiding the activities of the strategic managers. The Top management of the firm needs to have innovation skills for them to be able to sustain the firm in the market by making strategic choices. The theory will be used to anchor the business regulatory environment variable in the study.

2.1.5 Balanced Score Card

The proponent of the paradigm of balanced score card was Kaplan and Norton [112]. The model came up as critique of how performance was conceptualized; which was traditionally measured in financial terms like profitability, return on investments and return on assets. They came up with the Balanced Score Card (BSC) tool which measured performance holistically both financially and non-financially.

Non-financial measures included satisfying stakeholders and customers, growth and survival of business, and increased quality and efficiency [113]. The theory believed organisation performance should go beyond understanding the financial gains to include those who interact with business whether they are satisfied. Hubbard [114] improved BSC to include Sustainable Balanced Score Card (SBSC) which had six pillars namely financial, customer, internal business, learning, social and environmental performance. The models inform this study since performance variable is the ultimate factor in this study

and it necessary to have theoretical underpinning relating to MFIs performance. This study will be based on portfolio quality, efficiency and productivity, financial management and profitability as the key performance indicators which are covered in some elements of the balanced score card.

2.2 Empirical Review

2.2.1 Absorptive Capabilities and Performance

Absorptive capability refers to a firm's ability to utilize external knowledge through the sequential learning processes of acquisition, assimilation, transformation and exploitation [64] [77]. Daspit [115] research on understanding the multi dimension nature of absorptive capacity in software industry provides literature on the indicators of absorptive capability and their complimentary effect on performance of firms. The study found that there are four sub capabilities of absorptive capacity; acquisition, assimilation, transformation and exploitation. These sub capabilities were positively related to each other in a sequential manner. Absorptive capacity was also found to have a significant relationship with performance.

Key informant approach was used to collect the data with surveys being administered. Data collection was by use of Dillman's total design method. Data was collected from 152 firms and firm size was the control variable. ROA and net profit were the indicators for firm performance. The contextual gap is that the study was biased on soft- ware industry. Internal reliability of two components was below 0.70 Cronbach's alpha as recommended by Nunnally [116].

Research by Kostopoulos [28] on absorptive capacity, innovation and financial performance among 461 Greek enterprises found out that absorptive capacity leads to direct improved innovation performance and indirect financial performance over time. A significant correlation between absorptive capability- innovation and innovation –financial performance relationships. Engaging with other stakeholders (suppliers, clients, competitors and research institutions) in the industry enriches the knowledge base and develops their absorptive capabilities. The study further found that absorptive capacity is an enabler of strategic decision making and both innovation and financial performance successes. Further, absorptive capacity plays mediating role between external knowledge inflows and innovation. It is also a source of competitive advantage.

Absorptive capabilities were measured using an integrative approach of both qualitative and quantitative indicators of research and development, training and education level of employees. The research design for the study was longitudinal. The researcher used control variables; firm size, firm age and market type. Path analysis was used to test the hypotheses and the sample size of 461 was enough to attain statistical conclusions.

The conceptual gap from the study is that absorptive capability was considered as a mediator while in the current study it will be an explanatory variable. The research was limited to innovation firms only and thus not easy to generalise. The study used quantitative data yet the indicators

of absorptive capability are more of qualitative in nature. The study was biased to one country only; Greece. Panel data analysis would have been better for the analysis. The duration was minimal; 2000-2002. The research was biased on resource based view and evolutionary theory of the firm.

Li and Liu [117] empirical study on relationship between dynamic capabilities, competitive advantage and environmental dynamism in Chinese firms found out that dynamic capabilities help a firm in solving problems, sensing opportunities and threats within the environment it operates in and make timely decisions and implement strategic decisions and changes so as the firm remains on focus. The study was based on 217 Chinese firms. Dynamic capabilities significantly affected competitive advantage. Environmental dynamism was found to be more of a driver than a moderator. Contextual gap existed because the research was based on Chinese enterprise firms.

Empirical studies by Kihara [32] on the influence of dynamic capabilities on the performance of large manufacturing firms in Kenya found out that dynamic capabilities had a positive and significant influence on performance of large manufacturing firms. The research had a sample size of 217 firms and used a cross sectional research design and descriptive survey design and positivism research philosophy. The study used the sub capabilities of dynamic capabilities as sensing capability, learning capability, networking and innovation capabilities. The measures of performance for the research were ROE, profit before tax and ROA. Ordinary least squares regression model was used to test the hypotheses. The study didn't have any moderating or mediating variables.

Research by Yam et al [65] on advancement of literature on absorptive capacity opined that absorptive capacity involves the learning process that includes combination of acquisition, assimilation, transformation and exploitation. They further found a link between the absorptive capacity and technological innovation and product innovation which all enabled improved firm performance among 200 industrial firms in Hong Kong. Research by Osisioma et al, [57] on dynamic capabilities and performance of commercial banks in Awka, Anambra state, Nigeria. The research was based on sensing capability dimension of dynamic capabilities and influence on performance. Descriptive survey research design was used and data was collected by use of questionnaire. Product moment correlation was used to test the hypothesis and the finding was that there was a significant relationship between sensing capability and performance. The study was anchored on dynamic capability theory. Methodological gap from the study is that it focused on one capability only.

Nyachanchu, Chepkwony and Bonuke [118] empirical research on dynamic capabilities influence on performance of manufacturing firms in Nairobi County, Kenya. The study was based on resource based view theory. The study was based on the general influence of the three dimensions of dynamic capabilities; sensing, sensing and reconfiguration capabilities, on performance. It used an explanatory research design for the cross sectional survey.

Data was obtained from 271 manufacturing firms using a structured questionnaire sent to the firm CEOs. The study was anchored on logical positivism philosophical foundation. Regression analysis was used to test the hypotheses and found that the three dimensions had a significant influence on firm performance both individually and combined. Contextual gap as the study was on manufacturing firms.

2.2.2 Adaptive Capabilities and Performance

Adaptive capabilities focuses on how the institution learns from the adopted ideas and utilizes that knowledge in the interest of the institution so as to be able to develop new products as well. Gibson et al., [67] espoused that adaptation capability is related with those firm processes that facilitate strategic flexibility.

Monferrer et al., [29] research on born globals through knowledge based dynamic capabilities and network market orientation influence on firm performance found out that network market orientation facilitates the development of dynamic exploratory capabilities (adaptation and absorption capabilities) which in turn influence their capacity to exploit knowledge through innovation thus improving performance among born globals in Spain. Absorption capability had a significant influence on adaptation capability and innovative capability. On the contrary adaptation capability and absorption capability had no significant effect on international performance. The dynamic capabilities played an ambidextrous role.

Born globals participation in market oriented networks further encouraged the generation of innovation capability in them. Confirmatory factor analysis was done to using structural equations models (SEM) technique to ensure reliability of the scales. SEM technique was used to test the hypotheses since it allows for simultaneous series of relationship of variables. The study did not analyse the specific effect of each variable and innovation capability was not analysed as an element of the overall dynamic capabilities but as a product of adaptation and absorption capabilities. The study was based on Spanish born globals in the international markets thus the results cannot be generalised to other contexts. The study used an online questionnaire addressed to the manager and the challenge of confirming whether the response was from the manager emerges. The use of transversal data is a limitation when drawing causal inferences. The study was based on a single interviewee from each firm and this brings about the likelihood of biasness. Turnover, market share, profitability, market access and global satisfaction were the performance indicators in the study.

2.2.3 Innovative Capabilities and Performance

Innovation provides a firm with strategic orientation to overcome problems as it strives towards sustainable competitive advantage [44] [119] [120]. Innovation is an essential component of competitiveness and it is embedded in firms products and services, processes and organizational structures. It enables a firm enter new markets as well [51]. Bhan argued that the African continent was the leader in the

adoption of mobile platform for financial services [121]. This is based on the innovative capability of institutions.

Research by Gemici et al [122] found out that innovative capability and timely strategic choices played a big role in influencing the performance of Turkish Air transport industry since it created an increase in competitive advantage and market size. This study will be reviewed. The Turkish airline in response to the competition came up with two innovative conflicting positions at the same time that enabled it to operate in the domestic and global market while maintaining its focus on the customers. This innovation of expanding its market with focus on its customers made it have competitive advantage. The study focus was limited to the aviation industry and thus not easy to generalize in other industries. Only one dynamic capability; innovative capability was focused on in the research. The study further was limited to the domestic market only and relied on quantitative data only. The study was focused on the innovation theory only.

Research by Wendra, Sule, Joeliatyn and Azis on exploring dynamic capabilities, intellectual capital and innovation performance in garment manufacturing used intellectual capital as the mediator and not dynamic capabilities as in other other studies. The researcher used accidental and snowballs sampling techniques. Questionnaires were used to collect data from 297 SMEs in Indonesia. Descriptive data was analysed using Microsoft Excel 2007 and hypotheses tested using partial least squares method. They found out that dynamic capabilities had a significant influence on innovation performance and intellectual capital. Intellectual capital partially mediated the dynamic capabilities relationship with innovation performance [123].

Innovation was considered as a performance and not a capability in this study with product innovation, process innovation, marketing innovation and organizational innovation as the dimensions. The indicators for dynamic capabilities were strategic sensing, decision making and change implementation. Contextual gap existed because the study was conducted in the manufacturing sector and in Indonesia. Conceptual gaps existed on the sub capabilities of dynamic capabilities.

Danneels [124] research on product innovation found out that production innovation is key for firm performance since it helps in firm renewal. The renewal of firms is important because of the dynamic nature of the environment within which they operate. Customers play a critical part in firm development of products and the choices that firms make for different innovations vary. New products have a reciprocal relationship with their competencies. The study was based on resource based view. Data was collected using interviews, observation and document as sources of secondary data on high tech firms. They data was collected from 5 firms only and thus a contextual challenge of generalization in other sectors.

Process innovation which is a source of competitiveness among industries involves the propensity and effectiveness of firms to implement and introduce new production, supply chain or administrative processes of firms to introduce process innovations [125]. Moreover, research by Hervas-Olivier et al.,

[126] on process innovation strategy, organizational innovation and performance of 2,412 SMEs in Spain found out that research and development efforts are not positively related to production process performance but it is improved by synchronous co-adoption of organizational and technological innovation. Process innovation indicators; cost reduction, flexibility and capacity improvement were used. The research was based on resource based view. Questionnaires were used for data collection. Ordinary least squares method is used for hypotheses testing. Contextual gap was on the Spanish realm of the study.

Empirical research by Gunday et al [51] on effects of innovation types on firm performance found out that innovation positively affects performance. The research was based on 184 manufacturing firms in Turkey. Innovation capabilities indicators were; process, market, product, and organizational innovations indicators. Innovative performance was found to mediate between innovation types and performance aspects. The relationship between organisational and product innovation and process innovation and innovative performance were found not to be significant. Face to face interviews and questionnaires were used to collect data. SEM approach was used to test the hypotheses. The contextual gap was on the Turkish realm of the study.

Research by Terziovski [127] on innovation practice and its performance implications in small and medium enterprises in manufacturing sector in Australia found out that innovation culture and strategy are closely aligned throughout the innovation process and they are key drivers to performance yet they are not used in a strategic and structured manner. The study was anchored on resource based view. The study was on a sample of 600 Australian SMEs. The independent variables for the study were innovation strategy, formal structures, customer and supplier relationships, innovation culture and technological capabilities.

The dependent variable was SME performance with several indicators; number of product configurations, success of new products launched, faster speed of market, reduction in waste, increased market opportunities, increased delivery in full on time, improved product innovations, improved work methods and processes and increased quality. Multiple regression analysis was used in the testing of the hypotheses on the relationship between the independent variables and dependent variables and found out that innovation strategy and formal structure had positive and significant influence on performance. Innovation culture, customer and supplier relationships and technological capabilities were not significant. The study gathered quantitative data from one respondent in each SME and was in the context of SMEs in Australia. This makes its generalization difficult to other sectors and countries.

Al-Shuaibi, Zain and Kassim [128] study on performance indicator for quality, innovation and competitiveness among Saudi manufacturing sector found out that quality positively and significantly influenced the competitiveness of firms, quality influences performance if mediated through competitiveness, innovation positively and significantly influenced performance and competitiveness, innovation

influence performance through mediation by competitiveness and competitiveness positively and significantly influenced financial performance. The data through an electronic questionnaire sent to CEO/ Operations managers in each of the 223 companies.

Performance indicators were average sales growth, average profit growth, average ROI, average ROA, average growth in demand for products/ services, average growth in exports and average growth in number of employees. Innovation indicators were; latest technology, product/ services, operations improvement. SEM was used to test the hypotheses. Contextual gap was on the Saudi realm of the study and manufacturing sector.

Prajogo and Ahmed [129] empirical research on relationship between innovation stimulus, innovation capacity and innovation performance on 194 Australian managers of Australian firms found that the relationship between innovation stimulus and innovation capacity and between innovation capacity and innovation performance were significant and strong. Innovation stimulus was mediated through innovation capacity for it to have effect on innovation performance. Technology development, leadership, managing knowledge and culture of innovation were the indicators of innovation stimulus while innovation capacity had technology management and research and development management as its indicators.

Innovation performance was measured by product innovation and process innovation. Data was collected by use of questionnaires to a random survey of 1000 managers with knowledge on innovation. Construct validity and reliability requirements for the data were met. SEM method was employed in analyzing the three hypotheses of the research. The methodological gap was on the self-report nature of data collection and contextual gap was on the Australia realm of the study.

In addition research on the link between dynamic capabilities, innovation and firm performance by Zhou et al.,[130] found out that dynamic capabilities have three distinct dimensions (sensing, integration and reconfiguration capabilities) which facilitate different innovation types; market or technical innovation. Sensing capability had significant effect on technological innovation and no significant effect on market innovation. Integration capability had no significant effect on both innovations. The study used innovation as a mediator and not part of the dynamic capabilities.

The study was based on a sample of 204 Chinese firms. Partial least squares structural equation modeling was used in the analysis of the hypotheses. Performance indicators used were ROA, Return on Investment (ROI), Market share and rate of sales. Standard questionnaires were used for data collection from the various companies; software, pharmaceutical, manufacturing, logistics, state owned enterprises, foreign-owned companies joint ventures and private firms. Harman single factor test was used to ensure the data didn't have CMV problem. PLS-SEM was used for analysis. All the indicators were reliable with a Cronbach's alpha $\alpha > 0.80$. This study

brings about a conceptual gap on the aggregates of dynamic capabilities.

2.2.4 Networking Capabilities and Performance

Networking capability aims at how institutions can work in union with other stakeholders in a synchronized manner through inter relations to meet the changing environmental demands. Gomes et al., [31] opined that when firms partner they can use their unique resources and competencies to develop complementary synergies that will enable them achieve competitive advantage. Inter connection of activities is also an element of networking capability.

Le and Nguyen [131] on the impact of networking on bank financing among SMEs in Vietnam found out that networks serve different purposes among SMEs. The networks include social networks, managerial networks, suppliers and customers networks and they all help in improving firm performance. The paradox of focusing on core competencies while diversifying and differentiating products and services by developing complementary innovative product- service innovations; servitization, through concentric strategic partnerships as postulated by Einola et al further brings about a research gap that needs to be addressed since MFIs are faced by that challenge as well [132].

Bustinza et al.,[31] on the research on product-service innovation and performance found out that collaborative partnerships through concentric strategic partnerships benefit manufacturing firms in a significant way by providing opportunities for downsizing, externalizing risks and sharing knowledge. Further, managerial and marketing innovations influenced performance. The study was based on a survey of 370 large manufacturing firms. Product-service innovation (servitization) was positively associated with manufacturers' performance.

Study was anchored on resource based view. Performance was in two forms; business performance and organizational performance. Business performance indicators were (profitability, profit level change and profit level). High research and development intensity and internal provision of services and partnership with knowledge intensive businesses were the moderators. The study was based on a cross sectional study of North America, Europe and Asia firms and this brings about challenge in generalizing the results to other contexts. A structured questionnaire was used to collect data. SEM was used to test the model hypotheses. The study did not explain on how the networks are formed.

2.2.5 Dynamic Capabilities, Strategic Choice and Performance

Panayiotou, Putman and Kassinis [133] espoused that change is not always the result of deliberate intentions, conscious choices and purposeful actions of individuals but rather an ongoing process that evolves through countervailing dynamics at multiple organization levels.

The survival of micro finance institutions like other institutions is based on the strategic choices that they make. Strategic decisions by firms are based on the five competitive

forces; intensity of rivalry, supplier power, threat of new entrants, threat of substitute products and buyer power [134]. The strategic choices are always geared towards competitive advantage that enables the institutions to develop and sustain their position in the industry. The decision requires a clear strategic choice process.

Dichter and Harper [135] opined that MFIs need to rethink some policies since MFIs are not a panacea and that they may be damaging the intended customers. Superior performance in institutions can only be achieved through better and timely strategies that are achieved through making strategic choices by institutions top management. Making strategic decisions and taking corrective actions are some of the key functions in strategic management. Wilden, Devinney and Dowling [136] postulated that only firms that are able to create and sustain competitive advantage are the only ones that survive. This is echoed by Zott [24]. The essence of firms is to stay lucrative and solvent and this can only be achieved by the firm achieving its objectives; internal and external [33].

Study by Gemici and Alpan [122] on disruptive innovation application in creating competitive strategy within the Turkish Airline industry found out that innovative capability and timely strategic choice play a big role in influencing the performance of Turkish Air transport industry. Regulatory environment through government policies and ameliorations might lead to new entrants in the industry and thus firms must learn and prepare on how to respond to the new competition by making new strategies. Globalisation effects also need to be prepared for by firms.

The Turkish airline in response to the competition came up with two conflicting positions at the same time that enabled it to operate in the domestic and global market while maintaining its focus on the customers. The importance of strategic choice in making firm strategic decisions. This supports the OODA loop model idea of quick response in making decisions so as to be ahead of the rivals. The study focus was limited to the aviation industry and thus not easy to generalize in other industries. Only one dynamic capability; innovative capability was focused on in the research. The study further was limited to the domestic market only and relied on quantitative data only.

2.2.6 Dynamic Capabilities, Business Regulatory Environment and Performance

Empirical study by Harash et al., [95] on contingency factors and performance of research and development among universities in higher education in Iraq found out that government policy had a moderating effect on the relationship. Government policy is part of the regulation which might also affect micro finance institutions. Existence of legal framework through micro finance laws and regulations in Morocco has helped in fostering the growth of Moroccan MFIs [42].

The research used a case study approach combined with correlation analysis to identify controllable institutional factors that could be used to in regulation of MFIs in Morocco. Use of small sample size was a challenge. The contextual challenge was that the research was in Morocco and North Africa

countries which have different political systems and stability. The MFIs were also not finically related.

Legal framework provides the enabling environment for growth of MFIs. Armendáriz et al., [99] found out that MFIs suffer from mission drift challenge in that they deviate from their initial mission of alleviating poverty. Study by Okibo and Makanga [137] on Microfinance effect on poverty reduction in Kenya used business regulatory environment as the intervening variable of the relationship between credit facilities and poverty reduction. The indicators for business regulatory environment were CBK regulations and supervision guidelines on MFIs. Linear regression was used in the analysis. The study had conceptual gaps since it had different dependent and independent variables from those that this study will look at.

Gemici et al., [122] on disruptive innovation application in creating competitive strategy within the Turkish Airline industry found out that government deregulation policies can lead to an influx in new entrants in the market and this calls for a response by the firms in the industry. The study focus was limited to the aviation industry and thus not easy to generalize in other industries like the MFI industry and the regulations affecting the aviation industry are different from those in the MFI industry.

Study by Mugo et al., [96] on moderating effect of government policies on relationship between mobile technology services and performance of deposit taking SACCOs in Kenya using a descriptive and explanatory research designs. Data was collected from 86 Deposit- Taking SACCOs. Data was collected by use of questionnaires. Found that government policies positively moderated the relationship between mobile technology and performance.

The research adopted a positivism philosophy. The dimensions for government policies were; data security policies, mobile banking policies and SASRA policies. Performance indicators were; ROA, liquidity ratio and membership. Contextual gap exists because the study was based on deposit taking SACCOs. The study found out that government policies significantly moderated the relationship between mobile technology services and performance of deposit taking SACCOs.

2.3 Proposed Conceptual Framework

The conceptual model is based on the discussions presented in the literature review. The conceptual framework Fig.1 presents the researcher's schematization of the relationships of the current study variables. The variables include dynamic capabilities, strategic choice, business regulatory environment and MFI performance.

The study hypothesises that dynamic capabilities affect performance of MFIs in Kenya. There are four sub capabilities of dynamic capabilities; absorptive capabilities, adaptive capabilities, innovative capabilities and networking capabilities. These are the explanatory variables while MFI performance is the outcome variable. Strategic choice will be hypothesised as the mediating variable and business regulatory environment as the mediating variable. The indicators for strategic choice are strategic intent, strategic analysis, strategic

options and strategic selection. The indicators for business regulatory environment are the organizational and national culture, industry self-regulation, prudential and non-prudential regulations, government laws and regulations that affect conduct of micro finance institutions. The proposed research propositions based on the extant literature are;

Proposition 1. Absorptive capability will positively affect performance of MFIs in Kenya.

Proposition 2. Adaptive capability will positively affect performance of MFIs in Kenya.

Proposition 3. Innovative capability will positively affect performance of MFIs in Kenya.

Proposition 4. Networking capability will positively affect performance of MFIs in Kenya.

Proposition 5. Strategic choice mediates the relationship between dynamic capabilities and performance of MFIs in Kenya.

Proposition 6. Business regulatory environment moderates the relationship between dynamic capabilities and performance of MFIs in Kenya.

III. CONCLUSION AND DIRECTION FOR FURTHER RESEARCH

Based on the extant literature reviewed there has been varied relationship; both significant and non-significant between dynamic capabilities and performance. The sub capabilities of dynamic capabilities are; absorptive capability, adaptive capability, innovative capability and networking capability. Strategic choice and business regulatory environment have been mediating and moderating variables respectively.

The three constructs; dynamic capabilities, strategic choice and performance can be fully conceptualized in one study.

Integration of the various theories like resource based view, dynamic capabilities view, theory of innovation, contingency theory and attention based view in one study can be researched on.

Research on how firms identify their COG can be also researched on since COG analysis is critical for its attack or protection.

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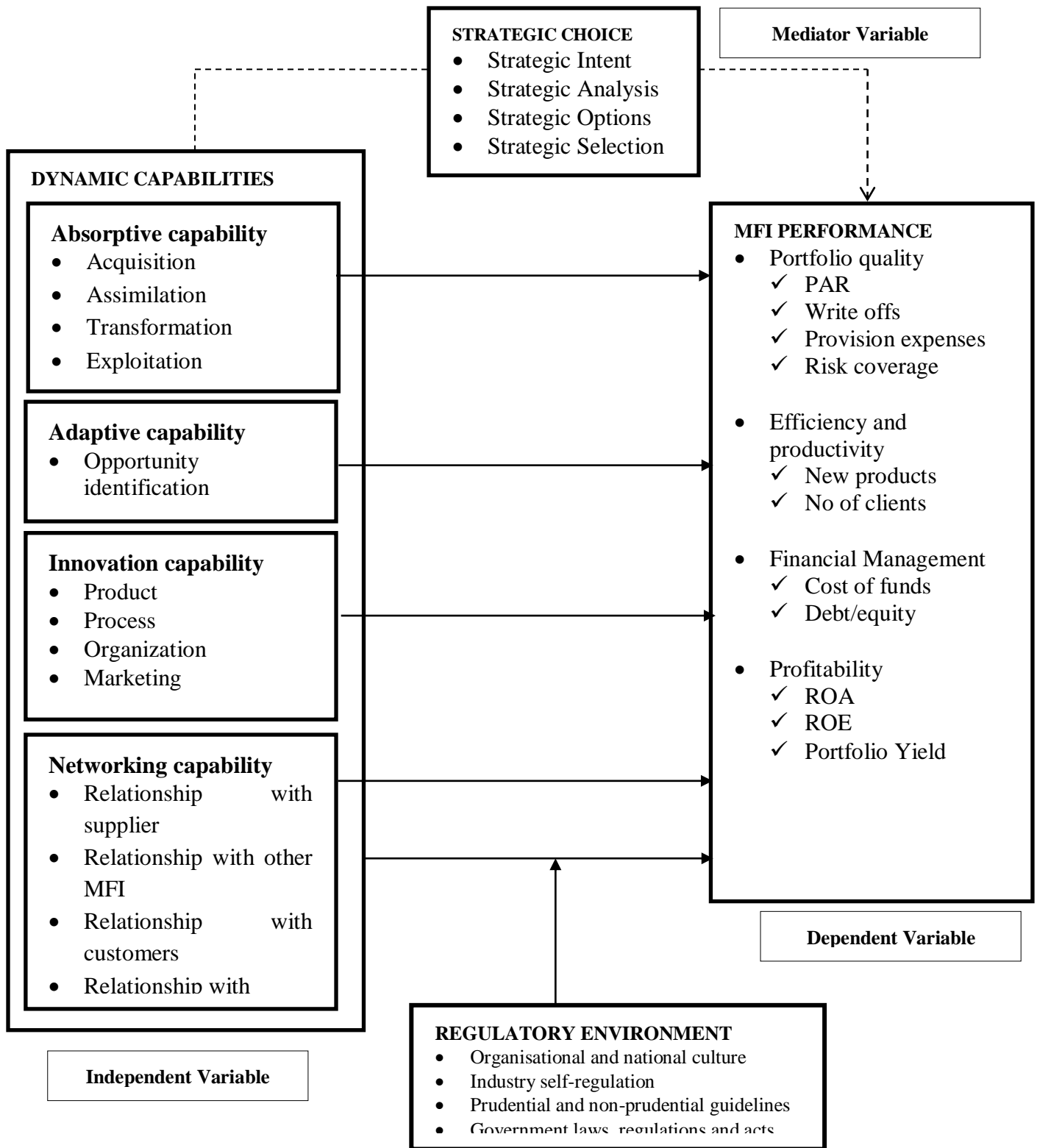


Figure.1 Proposed Conceptual Framework Source: Researcher (2019)