The Effect of Regulations on Performance of Microfinance Institutions in Promoting Small Business Growth in Ghana

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DECLARATION

I certify that the substance of this thesis has not already been submitted for any degree and is not currently submitted for any other degree or qualification.

I certify that any help received in preparing this thesis, and all other sources used, have been duly acknowledged in the thesis.

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DEDICATION

This thesis is dedicated to my loving and supportive husband, Jonathan Dagadu Quartey and precious daughter, Joanna Efa Quartey who sacrificed so much to ensure the successful completion of my work.

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ABSTRACT

Microfinance institutions (MFIs) have emerged to provide financial services to the poor who were hitherto, excluded from the formal financial system. MFIs have pursued the objective of providing financial services to the poor through two different approaches: the welfarist approach and the institutional approach. The welfarist approach focuses on poverty alleviation by emphasizing the depth of outreach, i.e. reaching the very poor and vulnerable in society with microfinance products. The institutionalists, on the other hand, focus on institutional sustainability by pursuing financial self-sufficiency while serving significant numbers of the poor i.e. breadth of outreach. Despite differences in the two approaches, the performance of MFIs should be assessed on the extent to which they fulfil their common objective of meeting the financial needs of the poor. However, for MFIs to reach out to large numbers of the poor with financial services, their businesses should be conducted on sound operating principles. This requires that MFIs are regulated. Regulation is therefore, important to effective operation of MFIs but can limit their ability to reach the very poor with appropriate financial services. Up until recently, MFIs in Ghana were regulated by various bodies. The rural and community banks and savings and loan companies, regulated by the Bank of Ghana (BoG), had the most rigorous compliance requirements ensuring effective governance. In contrast “susu” operators, regulated by the Ghana National Association of “Susu” Collectors, had the least compliance requirements and the most weak governance structures. This study seeks to examine the effect of regulation on the performance of MFIs in promoting small business growth in Ghana. Small business provides an avenue for income generation by a large segment of the poor, many of whom do not have the qualifications and experiences to be employed in positions that generate sufficient income to meet their needs.

Outreach and financial sustainability are the main performance measures used in the majority of studies to assess performance of MFIs. While these measures are concerned with the health of the financial institutions and the extent to which they meet the objective of reaching out to the poor, they fail to consider the effect of MFI products on the livelihood of their clients. The products of MFIs must make an impact on the livelihoods of their clients if they are to be effective in meeting the common objective of poverty alleviation. To investigate the effect of regulation on performance of MFIs, this study adopted a framework that incorporates outreach and financial sustainability as well as the impact of MFIs on the businesses of their clients as measures performance. The interrelationships among the various performance measures were also assessed. Two types of regulated MFIs were examined; the BoG regulated MFIs and the self-regulated “susu” operators.

A mixed method research design was employed, comprising both quantitative and qualitative research methods. Fifty-five MFIs (24 BoG regulated MFIs and 31 self-regulated MFIs) and 164 clients of the MFIs were surveyed using structured and semi-structured questionnaires in face–to–face interviews for the quantitative phase of the study. In the second phase of the study, a qualitative research method was used to triangulate findings from the first phase. This involved in-depth interviews with managers of 33 MFIs. Focus group discussions were also held with 24 clients of the MFIs.

Performance of the MFIs was assessed by descriptive and inferential statistics while hierarchical regression and binary mediation tests were employed to examine the effects of regulation on the performance measures of outreach, financial sustainability and impact. Deductive thematic analysis was also used to analyse the qualitative data.

With respect to interrelationship among the performance measures, the results revealed a positive correlation between average loan size as a measure of depth of outreach and operational self-sufficiency, an indicator of financial sustainability of the MFIs. This finding implies that the need to remain sustainable could result in the exclusion of poor borrowers who usually require very small amounts of loans. This is because the administration of small loans is costly to the MFIs. The study also revealed that the BoG regulated MFIs reached out to more clients (breadth of outreach) than the self-regulated MFIs. However, the self-regulated MFIs were able to reach out to the poorer segment of the society (greater depth of outreach) than the BoG regulated MFIs. These findings suggest that regulatory involvement increases the client base but reduces the percentage of poor clients, many likely to be women. Furthermore, the study found that regulation increased the operating costs of MFIs, although these were offset by an increase in income through increased outreach, ensuring financial sustainability of BoG regulated MFIs. However, regulations did not have an effect on the impact of MFIs’ products on their clients’ businesses. This may be due to the myriad other factors that affect performance of clients’ businesses that could not be controlled for in the quantitative study.

In general, the findings suggest that regulations enhance corporate governance in MFIs and force them to increase their revenues to meet the high cost of operations. In turn, MFIs are

compelled to reach out to those with good credit risk, to provide bigger-sized loans and to reduce their administrative costs. Regulations therefore push MFIs away from their initial objective of providing financial services to the poor who are excluded from the formal financial system. This runs counter to their original mandate of helping to reduce poverty. Nonetheless, the governance structures imposed by regulation are necessary for access to wider revenue sources and for financial sustainability of the MFIs.

Given that regulations enhance performance of MFIs, the recent move by the Government of Ghana to regulate all MFIs is in the right direction. Since regulations limit the ability of MFIs to reach out to the poor, it is recommended that the Government of Ghana set up a fund for the underprivileged and deprived in society which could be accessed by well-structured and well-performing MFIs to provide the critical services of reaching the poor with financial services. The ability to reduce operating costs could also help manage the trade-offs between depth of outreach and financial sustainability. MFIs should identify efficiency drivers, that is, factors that reduce their operating costs to enhance their efficiency. Careful management of operating costs could enhance the financial sustainability of the MFIs and enable them to extend their outreach to the disadvantaged in society. MFIs should also design and deliver innovative products and services that meet the needs of small business operators to sustain and enhance the growth of their businesses and ultimately reduce poverty.

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LIST OF ABBREVIATIONS

ACEP	Agence de Crédit pour I'EnterprisePrivée
ACIA	Average change in Asset
ACIP	Average change in profit
ACIS	Average change in stock
ADB	Asian Development Bank
ADOPEM	Asociación Dominicanapara el Desarrollo de la Mujer
AfDB	African Development Bank
ALR	Annual loan loss rate
ALS	Average Loan Size
ANOVA	Analysis of variance
AROA	Adjusted return on assets
ASCA	Accumulating Savings and Credit Associations
ASSIP	Agricultural Services Investment Project
BKD	BadanKreditDesa
BoG	BoG - Bank of Ghana
BRAC	Bangladesh Rural Advancement Committee
BURO	Bangladesh Unemployed Rehabilitation Organization
CSR	Catholic Relieve Service
CBAO	Compagnie Bancaire de I'Afrique Occidentale
CBO	Community Based Organizations
CBRDP	Community Based Rural Development Programme
CEOs	Chief Executive Officers
CGAP	Consultative Group to Assist the Poor
CUs	Credit Unions
DANIDA	Danish International Development Agency

DFID	Department for International Development
EMPL	Employment
ERP	Economic Recovery Programme
FFH	Freedom from Hunger
FINCA	Foundation for International Community Assistance
FINSIP	Financial Sector Improvement Project
FNGOs	Financial Non Governmental Organizations
FSS	Financial self-sufficiency
GAMC	Ghana Association of Microfinance Companies
GB	Grameen Bank
GCCUA	Ghana Co-operative Credit Unions Association
GCSCA	Ghana Co-operative Susu Collectors' Association
GDP	Gross Domestic Product
GHAMFIN	Ghana Microfinance Institutions Network
GHAMP	Ghana Microfinance Policy
GNP	Gross National Product
GSS	Ghana Statistical Services
GVLMA	Global Validation of Linear Model Assumption
IAIS	International Association of Insurance Supervisors
IDA	International Development Agency
IFAD	International Fund for Agricultural Development
IPO	Initial Public Offer
KfW	German Development Bank
K-REP	Kenya Rural Enterprise Programme
LPD	Lembaga Perkreditan Desa
LPG	loan portfolio guarantee

MASLOC	Micro Credit and Small Loans Centre
MBB	Micro Banking Bulletin
MCS	Microcredit Summit
MDGs	Millennium Development Goals
MFIs	Microfinance Institutions
MM	Mix Market
NBFIs	Non-Bank Financial Institutions
NBSSI	National Board for Small-Scale Industries
NCBs	National Commercial Banks
NGOs	Non Governmental Organizations
NOAC	Number of Active Clients
OER	Operating Expense Ratio
OLS	Ordinary Least Square
OSS	Operational Self-Sufficiency
PSI	President Special Initiative
PWB	Percentage of Women Borrowers
PWC	Percentage of Women Clients
RCB	Rural and Community Banks
REP	Rural Enterprise Project
RFSP	Rural Financial Services Project
RIA	Regulatory Impact Assessment
ROA	Return on assets
ROE	Return on equity
ROSCAs	Rotating Savings and Credit associations
S&Ls	Savings and Loans
SAT	Snapi Aba Trust

SDI	Subsidy Dependence Index
SDR	Sustainability Dependency Ratio
SEWA	Self Employed Women's Association
SIF	Social Investment Fund
SME	Small and Medium-scale Enterprise
SOMED	Soweto Microenterprise Development
SPSS	Statistical Package for Social Scientist
UNCDF	United Nations Capital Development Fund
UNDP	United Nations Development Programme
USAID	United States Agency for International Development
WOCCU	World Council of Credit Unions
WWB	Women World Banking