Effects of Regulations on the Performance of Microfinance Institutions in Ghana: An In-Depth Case Study of Initiative Development Ghana (ID Ghana)

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Abstract

Ghana has been at the forefront in the fight against poverty and under development in the Sub-Saharan Africa. Many industry players see the rapid growth of microfinance as a panacea for the elimination of poverty and a sure way of financial equality and inclusion in most developing countries. The proliferation of microfinance institutions in Ghana and most sub-Saharan countries seems to be a signal for governments to come out with regulatory policies in this important industry. A mixed research method was adopted for the study with a questionnaire administered in addition to interviews with key staff and managers of Initiative Development Ghana. The findings of the study concluded that regulation of microfinance institutions by the central bank have a positive impact on their financial performance. It is recommended that the central bank upgrade the skills of its staff, employ more competent and qualified personnel to enable it execute its mandate as regulatory authority. A major limitation was the small sample size used in the study. Future studies should include bigger sample size.

Key Words: Microfinance Institutions, Financial Performance, Regulations, Financial Inclusion, Poverty Alleviation.

Introduction

Many industry players see the rapid growth of microfinance as a panacea for the elimination of poverty and a sure way of financial equality and inclusion in most developing countries. The proliferation of microfinance institutions in Ghana and most sub-Saharan countries seems to be a signal for governments to come out with regulatory policies. The records from Bank of Ghana put the registered number of microfinance institutions in Ghana at 468. They comprised 64 money lenders and 11 financial NGOs (Bank of Ghana, 2015).

The Bank of Ghana’s relatively laissez-faire position on the regulation, supervision and monitoring of new and established microfinance institutions operating in various capacities, providing numerous services and products have yielded mixed impact on the economy Some enthusiastic proponents of deregulation and free markets point out that this position has brought innovations into the industry, encouraging new entry into the microfinance landscape,
institutions ready to venture into difficulty terrains, competitive lending rates, increasing number of branches with the benefit of expanding access to more deprived communities (Njogu et al, 2012). On one hand, doping of client by fraudulent microfinance institutions, high interest rate on loans, loss of depositor’s money, and mass fold up among others should sound as warning for the central bank to sit up to find solution in order to bring sanity to the industry14.

Based on these premises, it was deemed critical financial and academic exercise to investigate the effects of regulations on the performance of microfinance institutions in Ghana. Among other things, the study was aimed at contributing meaningfully to the ongoing debate on how best to sustain the microfinance industry in Ghana and globally.

**Literature Review**

**Evolution of the Microfinance Sub-Sector in Ghana**

In Ghana, the earliest documented operation of a formal microfinance institution was in the 1955. However, informal microfinance has been with our people until its formal acknowledgement by the government. It is envisaged that these self-help groups and institutions can be a viable strategy to combat underdevelopment and create more avenue for the informal sector operators to access credit facilities. This is to improve their lot and also promote the financial integration of the informal sector to the mainstream financial sector of the economy.

The PNDC Law 328 made the setting up of different categories of financial and non-bank financial institutions an economic and financial priority (Republic of Ghana, 1991). This law and other regulatory frameworks brought about separation of MFIs into three broad categories namely:

The first to emerge from the policy were the formal suppliers of microfinance services and products such as savings and loans companies, rural and community banks. The second category included the semi-formal suppliers such as credit unions, financial non-governmental organizations (FNGOs), and cooperatives. Lastly, the third category was the informal suppliers such as “susu” collectors and clubs, rotating and accumulating savings and credit associations (ASCAs), traders, moneylenders, etc.


**Types of Microfinance Industry Regulations**

Generally, in the financial sector and the banking industry, there are basically two main categories of financial regulations adopted by most financial institutions, international organisations, central banks and other semi-autonomous supervisory agencies and associations. These are prudential and non-prudential regulations.

Prudential regulation mechanisms are used to make sure that institutions are able to meet the minimum capital requirements put in place by the government and the central governments. These regulatory measures are also intended to ensure that there is adequate and satisfactory level of liquidity of funds to meet the depositors’ demand at all times. These regulatory policies by central banks are supposed to create an impression of the financial institutions ability to absorb any shocks and risks to customer’s deposits and investment. It is meant to shore up confidence in the minds of the clients and investors (Fernando, 2004).

Christen et al, (2003) state that prudential regulation includes a mechanism, techniques or strategies that are aimed specifically at protecting the financial system as a whole against perceived crisis or shock. It is also to protect the safety of poor rural communities and small households’ deposits in individual institutions.

On the other hand, non-prudential regulation includes policies and measurements which are put in place to govern the operations, ethics, and behaviour of MFIs in line with their conduct of business. These non-prudential policies are not intended to address the financial soundness of individual financial institutions but to help streamline the general financial soundness and sanity of the business processes of the various institutions in the financial sector. Mention can be made of some non-prudential mechanisms and strategies such as the reporting and disclosure requirements; fit and proper requirements for directors and officers; licensing requirement; office set-up of which information and communication technology (ICT) is crucial inputs for successful running of any financial institutions (Jomini, 2011).

**Research Methodology**

This study used a mixed research technique to examine the effects of regulation on the performance and sustainability of microfinance institutions in Ghana. The study was conducted in the Greater Accra Municipality. The study population comprised the customers and clients of ID Ghana, field officers, management and staff of ID Ghana. Simple random and purposive sampling techniques were used to select sixty respondents. The researchers administered the questionnaires themselves after arrangements were made with ID Ghana.

Data collected from the questionnaire were analysed, summarised, and interpreted accordingly with the aid of descriptive statistical techniques such as total score, mean and simple percentage. Qualitative as well as quantitative methods were used in the analysis of the primary data collected. The use of Statistical Package for Social Scientists (SPSS 2013) and Microsoft Excel (2016) were employed and findings were presented in the form of tables, charts and figures.

**Results and Discussion**

**A Brief Highlight of MFIs Performance Indicators**

The financial and social performance indicators or benchmarks adopted for this study were the internationally approved criteria used by the World Bank, International Monetary Fund (IMF) and the MIX Market microfinance performance measurement tools.

**Products and Services Offered By ID Ghana**

The Initiative Development Ghana (ID Ghana) was found to be operating in the Greater Accra Municipality with its headquarters located at Dansoman. The main services and products rendered by ID Ghana are voluntary saving, micro-loans and credit facilities. ID Ghana also
specializes in business development services, business managerial and bookkeeping education and training for its clients in its catchment areas.

ID Ghana has also developed social service products that offer grants for poor families to subscribe to the national health insurance scheme. ID Ghana’s innovative training sessions for raising social awareness, given by peer educators who have been elected by group members and trained by MFI trainers has been acclaimed as one of the best. Another important service in place is the services of social workers to advice, support and accompany clients and their families who are mostly women in extremely difficult circumstances like divorce, sexual harassment, assault, marital problems etc.

Operational and Marketing Strategies

Initiative Development Ghana (ID Ghana) has several strategies and institutional structures put in place to be able to achieve these numerous functions. Savings mobilization is an important operation of most MFIs and the marketing strategies include issuing of savings booklets, mobile banking, voluntary savings and public education. The strategies adopted for savings mobilisation were advertisement, mobile banking, price penetration and public education.

The study findings show that ID Ghana used several strategies like public education, competitive interest rate on saving to mobilise savings (see Table 2). The above findings are in line with other studies by Goldstein et al (1999), who stated that voluntary or compulsory savings are directly linked to credit disbursement and are based on the idea that potential borrowers should prove their credit worthiness.

Trends of Absolute Financial Performance Indicators

This section of the paper tries to find out whether there is any effect of financial regulation on performance of MFIs in Ghana. This is done through an in-depth trend analysis of the absolute performance indicators.

Total Assets of ID Ghana

This section examined the trends in total assets of ID Ghana in the pre-regulated (2006-2010) and post-regulated (2011-2015) periods. As Figure 1 shows, total assets had a consistent growth from 2011 to 2015 with the highest assets growth reaching GHS 8,785,889 in 2015. There was an increased assets growth difference of GHS 6,672,500 which represented 76.01 percent.

This figure when compared with the same period in 2006 to 2010 though there was, again, a good performance in all the five-year period before the regulations. However, after the strengthening of supervisory and regulatory measures by the Bank of Ghana (BoG), there was over 100 percent jump in assets growth. This shows that regulations do have an impact on assets growth (see Figure 3). The total assets grew from stood at GHS 24,922,061 in 2011-2015 to GHS 2,675,221 in 2006 to 2010.

**Total Deposits of Id Ghana**

Fund mobilization is very essential to the operation and sustainability of MFIs. Client deposits are one of the financial management performance indicators used to measure the performance of MFIs globally. The trend analysis of total deposits of ID Ghana as revealed by Figure 2 shows that there was clearly a huge increase in client’s deposits of over 80 percent. The client’s deposit in the post-regulation period (2011-2015) was GHS 9,591,685.00 as compared to GHS 1,298,497 recorded in the pre-regulation period (2006-2010). This shows that the stringent financial regulations, policies and other measures put in place by BoG is gaining back the trust and confidence of the population after the financial scandal that hit the industry in 2011-2012 and the recent financial fiasco of several MFIs in Ghana collapsing which led to the loss of customer’s deposits. On the basis of this financial performance, it can be concluded that ID Ghana is experiencing positive effects of regulation.

**Total Loans and Advances Of Id Ghana**

The core objectives that brought about the idea of MFIs was the ability to extend small cash and financial credits to the poor in rural communities and women, through micro-loans and credit to alleviate poverty and raise the living standards of the people. On this basis of this, loan portfolio is a major indicator of the performance of MFIs if not the main criteria for measuring the success or failures of these institutions. Data trend from the Figure 3 indicates that the lowest amount of total loans and advances granted to clients in 2011-2015 cycle after regulation was over 60 percent higher (GHS 1,664,338) than that of pre-regulation period (GHS 775,940).

Figure 3: Total Loans and Advances of ID Ghana

![Gross Loan Portfolio](image)

**Source:** Field survey 2016.

Again, from the Figure 3, there was over 100 percent increase in the volume and size of loans disbursed to clients. This astronomical increase in loan disbursement observed in the
post-regulation period shows that regulations have had a positive effect on performance and sustainability of MFIs in Ghana. Microfinance industry scholars have all drawn the same conclusion that the exclusion of the private informal sector, petty traders, poor rural communities, the vulnerable and underprivileged women from the mainstream financial sector was the reason for the birth of MFIs to address this socio-economic market failure (Littlefield and Rosenberg, 2004; Otero, 1999; Murdoch and Hashemi, 2003).

**Breadth of Outreach of Clients**

Increasing the coverage area, number of clients and the size of services to the poor is the only way MFIs can achieve their core objective of providing financial services to the unbanked, the poor and underprivileged women in Ghana and globally. Clients’ breaths of outreach are the measurement of how many new clients have access to financial services.

Figure 4: Breadth of Outreach of ID Ghana Clients

![NUMBER OF CLIENTS](image)

Source: Field survey 2016.

The Clients’ breaths of outreach enable the researcher to find out the effects of regulation on expanding customer base and branches. From the Figure 4, indicates that client outreach was over 110 percent with 96 percent being women and 80 percent of these clients being in peri-urban sector. Available data from Figure 4 and the mix market indicates that Ghana have been able to reach more poor people in the last five years (in the post-regulation period of 2011-2015) which resulted in it being the first country to reduce poverty to one-half and thereby achieved the millennium challenge goal in the sub-Saharan Africa. The results from Figure 6 shows a year on year increase of over 200 percent in the ID Ghana’s drive to reach more clients.

**Financial Ratio Performance Indicators**

**ID Ghana’s Portfolio at Risk Ratio (PaR >30%)**

This section of the study tries to establish the Portfolio at risk (PaR) ratio of ID Ghana in the period 206-2010 and 2011-2015. Portfolio at risk (PaR) is an indicator used to determine the portion of the portfolio that is “contaminated” by arrears and therefore, at risk of not being paid.

By national and international measurement benchmarking, an MFI’s portfolio at risk (more than 30 days) should not be above 10 percent. Portfolio at risk shows the portion of the portfolio in arrears and it is at risk of not being repaid. The older the delinquency, the less likely that the loan will be repaid therefore any loan at risk exceeding 10 percent must be seen as a red light.
The data for post regulation period in Figure 5 shows that ID Ghana had the highest percentage in its PaR in 2011. It rose from 1.62 percent in 2010 to 33.89 percent in 2011. There was a further downward trend to 16.04 percent in 2012 but increased again to 23.83 percent in 2013. Finally, it was able to achieve a downward trend and in 2015 (5.60%) which is far below the National benchmark for Portfolio at Risk (>30 days) which was 7.0 percent. However, this figure was far above the Global MFIs’ benchmark of 2.6 percent, Africa benchmark of 4.8 percent. It is however, a little lower that the West Africa benchmark of (5.9 percent).

Figure 5: ID Ghana’s Portfolio at Risk Ratio (PaR >30%)

<table>
<thead>
<tr>
<th>Year</th>
<th>PaR &gt;30%</th>
</tr>
</thead>
<tbody>
<tr>
<td>First</td>
<td>31.89%</td>
</tr>
<tr>
<td>Second</td>
<td>20.04%</td>
</tr>
<tr>
<td>Third</td>
<td>16.04%</td>
</tr>
<tr>
<td>Fourth</td>
<td>16.38%</td>
</tr>
<tr>
<td>Fifth</td>
<td>5.60%</td>
</tr>
</tbody>
</table>

Source: Field survey 2015.

**Loan Recovery Rate (%) of ID Ghana**

All MFIs need to protect themselves and their clients against excessive indebtedness and improve loan recovery. This enables them to achieve operational self-sufficiency and provide more micro-loans to others. The analysis revealed that there was high performance after the central bank regulations came into effect. And this was evident as data showed high rate of loan recovery (Figure 6).

Figure 6: Loan Recovery Rate (%)

<table>
<thead>
<tr>
<th>Year</th>
<th>Loan Recovery Rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>First</td>
<td>55.59%</td>
</tr>
<tr>
<td>Second</td>
<td>54.82%</td>
</tr>
<tr>
<td>Third</td>
<td>55.00%</td>
</tr>
<tr>
<td>Fourth</td>
<td>55.20%</td>
</tr>
<tr>
<td>Fifth</td>
<td>58.75%</td>
</tr>
</tbody>
</table>

Source: Field survey 2016.
The lowest rate of loan recovery in the post-regulation period was 93.0 percent which was even better than the highest rate for the pre-regulation period (74.61%). This result lends support to similar findings by Honohan (2004) and Rosengard (2001).

**Debt/Equity Ratio at ID Ghana**

The findings indicate that, the introduction of regulations that allowed registration of FNGO in Ghana led to increase in the value of assets and debt/equity ratio of these registered micro-financial institutions. This was corroborated by interview with some major industry players.

The ID Ghana’s post-regulations debt/equity percentage decreased throughout the study period from 9.67 (2011) to 1.04 (2015). Implying that, more equity is used to finance business than debt. Figure 7 compares the debt/equity ratio for the pre-regulation and post-regulation periods. The trend indicates that most of its operations/administrative expenses are financed by debt instruments and, should probably be regulated to safeguard client’s savings.

Figure 7: Id Ghana’s Debt/Equity Ratio%

**ID Ghana’s Returns on Equity (%)**

The Return on Equity (ROE) is the measure of the level of revenue earned on the use of the equity of the MFI. This ratio is frequently used as a proxy for commercial viability and sensitive to investor decision making.
The steady growth in total assets and equity, as illustrated in Figure 8 shows a favourable credit and equity supply environment. This could probably reflect a facilitating regulatory regime. The overall performance in terms of return on equity was 82.02 percent after regulations have been introduced to streamline the operations of the company as compared to -89930.81 percent in the pre-regulation period.

### Returns on Assets (%) of ID Ghana

Return on assets is an overall measure of profitability that reflects both the profit margin and the efficiency of the institution. That is how well the institution uses its assets to generate income. From the Figure 9, whilst the pre-regulation era had negative returns, the post regulated era had a positive benchmark. There was an upward trend performance from 8.31 percent in 2013 to 21.82 percent in 2015. This is a very important performance since FNGOs are mostly non-profit making bodies.

The amount of net return as a percentage of shareholder’s equity measures a corporation’s profitability by revealing how much profit a company generates with the money shareholders have invested. This can be used as a proxy for assessing commercial viability because most MFIs are not-for-profit-organization.

Source: Field survey 2016.
Perception on the Effects of Regulation

According to Jacobson (1999), financial performance is a tool used to measure the results of a company’s policies and operations in monetary terms; and results are reflected in the firm’s return on investment, return on assets and value added.

The results of the study showed that 71 percent of the respondents believe that the current regulatory framework, measures and policies would not decrease profits whereas 29 percent thought otherwise. A further probe through interview revealed that respondents who indicated that regulation will reduce profits, majority (60.3%) agreed that profits could be decreased by 15-30% whilst the rest believe that profits will fall by a small margin (1-8%).

However, all the 48 participants were in agreement that the benefits of regulation on MFIs far outweigh the cost because regulation has a positive impact on MFIs overall financial, social and economic performance in the long run if implemented in an expert manner (see Appendix 1).

Stephens (2008) concurred with these findings that regulation generally increases deposit mobilization. However, if regulation is not well implemented it faces the risk of impacting negatively on the provision of credit services and client base expansion to clients.

Figure 10: Management and Staff Perception on Effects of Regulation on Performance

Finally, majority of the respondents (71.43%) agreed that regulation has had positive effects on performance. This result are in line with a study by Demirgüç-Kunt et al (2004) who gave a similar conclusion that regulation of the financial sector in any form, policy framework is bound to have some minor drawbacks. These include sharp increase in capital reserve requirement which can curtail the amount and volume as well as the outreach on clients by MFIs and thereby increase cost microloans.

From the findings, the study can conclude that regulation had a positive impact on financial and social performance of MFIs. In spite of some drawbacks and challenges seen by MFIs due to regulation, 70.9 percent of the participants agreed that the central bank’s regulatory measures, laws and policies put in place have yielded very high and positive effects on performance of MFIs in the country. Whereas 25.0 percent of them said it has yielded medium impact on
performance 4.1 percent stated that it has a low impact on performance. All the respondents (100%) agreed that regulation of MFIs is needed and if well implemented will have a positive effect on the overall performance of the industry (see Appendix 1). Their reason was that regulations are needed to protect the soundness of the microfinance system in Ghana and client’s funds. Among other things, the recent financial scandals in Ghanaian MIFs landscape make it a paramount issue.

Conclusions and Recommendations

ID Ghana recorded increment in all the absolute performance indicators. The number of client outreach stood at 11,419 members in 2015 against 5,959 members in 2010. This represented 50 percent performance in customer’s base, coverage area and outreach with 96 percent of the clients being women. Again, active voluntary savers were 15,459 in 2015 compared to 8,195 in 2010. With regard to efficiency and productivity which indicate how the institution streamlined its operations, it was observed that the ID Ghana had reasonable efficiency ratios after the regulation as compared to pre-regulation period. The results showed that ID Ghana performed well in all the selected performance measurement indicators.

In conclusion, the central bank’s regulatory policies and the supervisory role have had positive influences on the performance of MFIs and the sustainability of the microfinance institutions in the country. From the findings, the industry players are of the view that regulation of MFIs is needed and if well implemented could have a positive effect on the overall performance of the industry.

From the results of the study, these recommendations are outlined for the attention of the various interested parties:

• The development of social services and products like health care and educational tailored to the needs of clients would help impact positively on the poor.

• Non-deposit financial NGOs have the mandate to convert to deposit taking institutions which can increase their outreach and capital base to be able to offer more help to the poor and reduce financial inclusion. The researcher recommends that such institutions should be encouraged to convert by the mother associations and the central bank.

• MFIs in Ghana should diversify their products and services to increase their clientele base and increase financial inclusion. Thus, ID Ghana and other institutions should offer other services such as micro transfer, micro insurance and micro leasing in addition to the loans and savings. There is the need for the central bank to upgrade the skills of its staff, employ more competent and qualified personnel to effectively execute its mandate as a regulatory authority. This will help improve the overall performance of the institution to achieve its mandate.

References

Journal


Books


Online Documents


Microfinance Transparency http://www.mftransparency.org/


Microfinance Transparency http://www.mftransparency.org/


Conference Proceedings


Report/ Thesis


Appendix

Appendix 1: Management and staff Perception on the effects of regulation on performance

<table>
<thead>
<tr>
<th>Effect of regulation on MFI performance</th>
<th>NO (%)</th>
<th>YES (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Will regulation reduce profits?</td>
<td>71.0</td>
<td>29.0</td>
</tr>
<tr>
<td>Will regulation reduce credit outreach?</td>
<td>81.3</td>
<td>18.7</td>
</tr>
<tr>
<td>Will regulation reduce loan size?</td>
<td>90.2</td>
<td>9.8</td>
</tr>
<tr>
<td>Will regulation affect poverty reduction by increasing cost of loans?</td>
<td>78.5</td>
<td>22.5</td>
</tr>
<tr>
<td>Will regulation affect client base? (reduction in clientele base)</td>
<td>62.5</td>
<td>37.5</td>
</tr>
</tbody>
</table>

Source: Computed from filed survey, 2016, n=48