



Microfinance in Ghana: Development, Success Factors and Challenges

Irene Akuamoah Boateng, Albert Agyei

To Link this Article: <http://dx.doi.org/10.6007/IJARAFMS/v3-i4/387>

DOI:10.6007/IJARAFMS /v3-i4/387

Received: 16 October 2013, **Revised:** 14 November 2013, **Accepted:** 28 November 2013

Published Online: 13 December 2013

In-Text Citation: (Boateng & Agyei, 2013)

To Cite this Article: Boateng, I. A., & Agyei, A. (2013). Microfinance in Ghana: Development, Success Factors and Challenges. *International Journal of Academic Research in Accounting Finance and Management Sciences*. 3(4), 200 – 210.

Copyright: © 2013 The Author(s)

Published by Human Resource Management Academic Research Society (www.hrmars.com)

This article is published under the Creative Commons Attribution (CC BY 4.0) license. Anyone may reproduce, distribute, translate and create derivative works of this article (for both commercial and non-commercial purposes), subject to full attribution to the original publication and authors. The full terms of this license may be seen at: <http://creativecommons.org/licences/by/4.0/legalcode>

Vol. 3, No. 4, 2013, Pg. 200 - 210

<http://hrmars.com/index.php/pages/detail/IJARAFMS>

JOURNAL HOMEPAGE

Full Terms & Conditions of access and use can be found at
<http://hrmars.com/index.php/pages/detail/publication-ethics>



INTERNATIONAL JOURNAL OF ACADEMIC RESEARCH IN ACCOUNTING, FINANCE AND MANAGEMENT SCIENCES



Microfinance in Ghana: Development, Success Factors and Challenges

Irene Akuamoah Boateng, Albert Agyei

School of Business, Valley View University, Oyibi, Accra

Email: ohenewah80@yahoo.co.uk, agyeialbert74@gmail.com

Abstract

Microfinance is defined as the provision of financial services such as loans to low-income households, the poor and microenterprises. Over the past decade, microfinance institutions (MFIs) have sprang up rapidly in the Madina area of Greater Accra region of Ghana. It is therefore critical to examine the actual aims of these MFIs. The impulse of this research is to assess the development of microfinance in the Madina area. The study conveniently sampled twelve microfinance institutions. The instrument used for data collection was questionnaire. The managers of these MFIs were purposively selected to respond to the questionnaires. The study revealed that the development of microfinance in the past five years has been with the sole purpose of, providing income to low-income households who operate their own businesses. In addition, the success factors are provision of services which were appropriate and consistent with customers' situation and needs, character-based lending, frequent visit of credit officers to customers. The major challenges were lack of adequate client information, higher information technology cost, lack of vehicle for transportation, higher utility cost, higher salaries, unwillingness of clients to provide personal information and lack of solid credit risk management policy.

Keywords: Microfinance, Microfinance Institutions, Funds for Microfinance, Success Factors of MFIs, Challenges of MFIs

Introduction

Microfinance can be defined as "the provision of a broad range of financial services such as deposits, loans, payment services, money transfers, and insurance to poor and low-income households and, their micro enterprises" (Baten, 2009). In the past, unethical moneylenders with extremely high interest rates have been the poor persons only source of capital due to the unwillingness of the formal banking sector to lend without any form of collateral backing. This led Sriram in 2005 to put it that microfinance has come to "bridge the gap between formal institutions and the poor by providing some intermediary mechanisms of transaction aggregation and rationalizing transaction costs."

The UNDP Human Development Report (1991 cited in Aborh, 2011) posits that the last decade has witnessed a significant transformation of the financial landscape of Ghana in terms of the diversity of institutions and the areas of focus. The report further put it that while the numbers and types of institutions have increased remarkably, accompanied by an array

of financial services. However, there is an observation that financial services remain inadequate, particularly for small borrowers and depositors, as well as the poor, thus leaving large sections of the society not catered for.

Since the humble beginnings of Microfinance in Bangladesh in the 1970s, it has grown in reputation as poverty alleviation tool to be developed and delivered by non-state actors outside formal markets. However, there is some concern among practitioners and academics that the rapid growth of the industry has led to narrowing of its focus to profitability and proliferation rather than transformation of clients' lives. In this regard, there is criticism that losing sight of this mission may lead microfinance into another example of poorly managed development finance, inattentive to the actual needs of vulnerable populations (Dichter 2007).

The definition of microfinance by Baten (2009), implies that microfinance is one of the major contributors of poverty reduction and job creation. From the assertion by UNDP Human Development Report (1991 cited in Aborh, 2011), there is no doubt that microfinance has become one of the fast growing sectors in Ghana. It is against this background that this study seeks to assess the microfinance sector in Madina Area of Greater Accra Region, Ghana.

The objectives of this study are;

- To examine the development of microfinance in Madina.
- To assess the success factors of microfinance businesses in Madina.
- To examine the major challenges facing microfinance institutions in Madina.

Definition and Scope of Microfinance

The need to achieve equity may have prompted state intervention in financial markets even in the absence of market failures since competitive financial markets distributed capital in a socially unacceptable ways. Government action was therefore required to protect and assist the vulnerable (World Bank, 2000 cited in Adjei, 2010). In this regard, microfinance institutions were developed with the aim of reaching the excluded population and to undermine the monopoly power of local moneylenders who charged ridiculously higher interest rates. Therefore two elements can justify government intervention to provide social insurance. Thus, government can invest in innovation, and also have the capacity to work at the national level so that it can cope with co-variant risks. Innovative arrangements can respond to equity requirements in particular by providing microfinance services in rural areas and for the poor population (Adjei, 2010).

Microfinance has been defined by different scholars in different ways. Micro-finance is defined by Baten in 2009 as the provision of a broad range of financial services such as deposits, loans, payment services, money transfers, and insurance to poor and low-income households and, their micro enterprises.

Furthermore, Microfinance Information Exchange (MIX, 2010) defines microfinance as a variety of financial services that target low-income persons, particularly women. According to them because most of the clients of microfinance institutions (MFIs) have lower incomes and often have limited access to other financial services, microfinance products tend to be for smaller monetary amounts (such as loans, savings, insurance, and remittances) other than that of traditional financial services.

Robinson (2001 cited in Imran et al., n.d) comprehensively defines microfinance as the; small-scale financial services – primarily credit and savings – provided to people who farm or fish or herd; who operate small enterprises or micro enterprises where goods are produced, recycled, repaired, or sold; who provide services; who work for wages or commissions; who

gain income from renting out small amounts of land, vehicles, draft animals, or machinery and tools; and to other individuals and groups at the local levels of developing countries, both rural and urban (p 9).

The definition by Robinson encompasses everything that microfinance is set to do by its establishment. Thus, it considers the operation of microfinance, the help it offers to people who needs it, the kinds of services provided by microfinance businesses, the category of people it serves and even the classes of people. Therefore the definition is one of the most comprehensive compared to all the other definitions cited above.

Microfinance operates through institutions. Therefore, it is imperative that microfinance institution is also defined. In this regard, Microfinance institution (MFI) is defined by Ablorh (2011) to consist of agents and organizations that are engaged in relatively small financial transactions using specialized, character based methodologies to serve low-income households, micro enterprises, small farmers, and others who lack access to the banking system. He claims that many MFIs provide social intermediation services such as group formation, development of self-confidence, and training in financial literacy and management capabilities among members of a group in addition to the financial services provided. Although some MFIs provide enterprise development services such as skills training, marketing, and social services, such as literacy training, proper home management and health care, they are not generally included in the definition of microfinance, (Ablorh, 2011). Microfinance covers a broad variety of institutional arrangements and approaches. They range from small self-help groups with a handful of members to huge organizations that have nationwide coverage and millions of clients. MFIs can be non-governmental organizations (NGOs), Savings and Loans Companies, Credit Unions, Government Banks, Commercial Banks, or Non-Bank Financial Institutions (Ablorh, 2011).

Sources of Funds for Microfinance

Fehr and Hishigsuren, 2005 claims that microfinance has received significant attention from the donor community, based upon its potential as a powerful tool of poverty alleviation. To them, this has led to millions of dollars been spent on promoting microfinance programs around the world. They posit that, the principal source of funding for MFIs is grants and highly subsidized loans, or so-called soft loans. Soft loans are loans obtained from multilateral banks, government aid agencies, foundations and apex organizations.

Over the years, deposits (i.e., demand deposits, passbook savings, time deposits, certificates of deposits) have been another primary source of funds for financial institutions. Unfortunately, this source of finance is derived only after the microfinance business has commenced. This makes this source available to only businesses that are in operation.

Hempel and Simonson (1999) agreed that deposits serve as a major source of finance for financial institutions as they reported that, United States commercial banks total liabilities are made up of 97 percent of demand deposits and time deposits. Wisniwski in 1999 also backed this assertion by reporting that, this has been true (thus, deposits as source of finance) but it cuts across regional or cultural context in which the banks or related non-bank financial institutions have developed. Fehr and Hishigsuren in 2005 categorized the sources of finance for MFIs into four stages. They assert that Stage I, represents the startup stage and is mostly financed by donor grants, soft loans and forced savings.

Stage II represents Operational Self-sufficiency and therefore is largely financed from donor grants, soft loans, forced savings, commercial loans and guarantee funds. Stage III which they termed as Financial Self-sufficiency at which stage the MFI is at maturity and

private debt capital available. They posit that, the debt structures are however often laden with restrictive covenants and often must have guarantees attached. They referred to the stage IV as Commercial Level Return of MFI evolution and as such makes traditional equity financing appropriate source of finance.

Furthermore, Ananth conducted a study in 2005 about financing microfinance. The study categorized the financing options into three models. She termed the first model as the self-help group (SHG)–bank linkage model which is characterized by self-help promoting institution (SHPI), usually a non-governmental organization (NGO), which helps groups of 15–20 individuals through an incubation period after which time they are linked to banks.

The second model is called financial intermediation by the microfinance institution, where the MFI borrows from commercial sources and on-lends to clients (groups/individuals). The third model is referred to as the partnership model – MFI as the servicer. According to Ananth, this model is characterized by loans contracted directly between bank and borrower; alignment of incentives with a first-loss guarantee structure; and transfer of implicit capital from the bank to the MFI through an overdraft facility.

Success Factors and Challenges of Microfinance

Success factors are factors that contribute to the sustainability and growth of microfinance businesses around the world. Some leading microfinance businesses like the Grameen Bank have been tested and proven overtime. It has withstood the test of time. Therefore, most microfinance businesses look up to the Grameen Bank as a role model of microfinance and to follow its success factors.

This led Mamun in 2010 to conduct a study about the success factors of the Grameen Bank. The study concluded that, the success factors of Grameen Bank (GB) include innovations such as design and implementation of policies like group-based lending, the collateral free lending system, peer group monitoring system, and well-trained and dedicated staffs of GB. The findings continued that GB motivates its staffs and borrowers through providing a well-designed incentive system for staff, allocation and mobilization of resources and encouragement of the borrowers to be financially independent.

Armendariz and Morduch (2004) found out that for MFIs to provide effective financial intermediation there should be a well-functioning regulatory framework in the host country. Woller and Woodworth (2001) also concluded that governments must create a macroeconomic environment characterized by stable growth, low inflation, and fiscal discipline in order for MFIs to thrive.

Hubka and Zaidi (2005) find that governments can help market-based microfinance by eliminating unfair competition from public institutions, undertaking overall regulatory reform, and improving the overall business environment. Crabb (2008) posits that factors affecting the sustainability of an MFI can be divided broadly between institutional and environmental variables. He defines institutional variables as those factors that are specific to the institution, while environmental variables comprises of policy and economic settings of the country the institution operates in. He asserts that business and regulatory environment is now considered an important factor in the success of microfinance institutions.

According to Adjei (2010), the key challenges confronting the microfinance sector in developing countries, like Ghana, are capacity building; inadequate and expensive infrastructure base; credit delivery and management; information gathering and dissemination; regulation and supervision. Muhammad (2010) also posits that the key

challenges facing microfinance businesses are improper regulations, increased competition from the formal banking sector, instability, limited management capacity, political interference, high transaction cost, inadequate investment in agriculture development, low level of knowledge. Woller and Woodworth (2001) also assert that poor macroeconomic, regulatory and trade policies can undermine the viability of MFIs to sustain.

Methodology of Research

The population for this research comprised all microfinance institutions (MFIs) in the Madina area of Greater Accra Region, Ghana. Since there is no statistics of the number of MFIs in Madina, it became impossible to use probability sampling method to select the MFIs to serve as sample size. The study employed non-probability sampling technique in selecting the sample size. Convenient sampling technique was used in selecting the microfinance institutions.

In all, twelve (12) MFIs were selected to represent the sample. These were CashPhase Microfinance Company Ltd, Olive Branch Capital, Onipanua Microfinance, Kwamans Microfinance Company Ltd., Sikapa Microfinance, Pro-Credit Savings and Loans Ltd., Opportunity International Savings and Loans Ltd., Catamount Finance, SSI Microfinance, Strategic Microfinance, Ezi Savings and Loans Ltd. and Common Capital Investment Microfinance.

Data collection was mainly from a primary source. The instrument used for data collection was a self-structured questionnaire. The managers were purposively selected to fill the questionnaires. The questionnaire was divided into three (3) sections based on the objectives of the study. The section A, consisted of information on the development of microfinance. Section B, the success factors of microfinance businesses. Section C, dealt with challenges of microfinance businesses..

The section A comprised both open and closed ended questions. The section B comprised mainly of closed ended questions with just one open ended question. The section C comprised only closed ended questions. A five point Likert scale was adopted for the section C and some parts of the section B. The respondents were required to indicate the extent of their agreement or disagreement with each of the statements on a score of one (1) to five (5). A score of one (1) represented strong agreement with the statement, while a score of five (5) represented strong disagreements.

The questionnaires were personally administered to the respondents. Descriptive statistical tools were used to present and analyze data collected. The data were analyzed through the use of percentages with the help of Statistical Package for Social sciences (SPSS) version 16.

Results and Discussion of Findings

The Development of Microfinance in Madina

It was revealed that majority of microfinance institutions in Madina (66.7%) had operated between one and five years. This means that most microfinance businesses in Madina are young and still developing.

Again, 60% of the respondents had the idea of forming microfinance businesses through experience. The experience was as a result of working with other microfinance companies in other parts of the country. Others were through their experience of working in the formal banking sector of Ghana.

Also, on the main aim of establishing microfinance business, 60% of the respondents indicated that it was to support income generation for enterprises operated by low-income households. This is backed by the assertion of Adjei (2010) that, microfinance business operate by providing services to the poor and low-income earners who may not have access to the formal banking services in the country.

Moreover, on the issue of how the respondents were able to raise capital to start their businesses, 80% of the respondents indicated that they raised capital through personal savings. This is in contrast to the findings by Fehr and Hishigsuren (2005) who asserted the major sources of finance for microfinance businesses are from donor funds.

Lastly, in relation to sources of funds for the microfinance institutions after their establishment, it was realized that, the major sources were deposits (66.7%), interest on loans (66.7%), and investment income (60%). This confirms the findings by Hempel and Simonson (1999), and Wisniwski (1999) who wrote that the sources of funds for microfinance businesses are from deposits.

To Assess Success Factors of Microfinance in Madina

The second objective was to identify the success factors of microfinance institutions. The success factors were examined based on the best practices of Grameen Bank, one of the earliest microfinance businesses that set the pace for other microfinance businesses. The respondents representing 100% agreed that they provided services appropriate and consistent with customers' situation such as loans. For a business to thrive, it depends on the customers that patronize the services. As a result, it was strategic that the microfinance businesses operated within the needs and situations of their clients. It is therefore not surprising that all the respondents indicated they provide services based on the situation and needs of their customer base.

Also, the microfinance businesses operated a character-based lending as indicated by 73.3% of the respondents. This means that, in line with loans services provided by the microfinance businesses, they give loans to clients based on the character of the individual and that is backed by operating flexible loans to customers which was agreed to by 100% of the respondents. This suggests that, based on the character and creditworthiness of the customer(s), different rates of interest may apply. The character of the customer is assessed through series of business transactions engaged in with customers and the repayment of loan pattern of the customers. Due to this, first time customers are not usually accessed because the character of the customer is not known at this stage.

Moreover, frequent visit of credit officers to clients' place of business was also a success factor. This was observed as 80% of the respondents agreed. This was also one of the success factors or best practices of Grameen Bank as was found by Mamun in 2010. Visits are to monitor the progress of their businesses and remind them of repayment of loans.

Finally, in line with the frequency at which credit officers visit customers' place of business, the responses received indicated that 44.7% were very often and 53.3% were often. This shows that the microfinance businesses are really in touch with their customers. This explains why majority of interaction between the businesses and the customers took the form of face-to-face as 93.3% of the respondents indicated.

To Examine the Major Challenges Facing Microfinance Institutions

Table 1

CHALLENGES	% of Agreements with Statement	RANK
Lack of qualified staff	46.7	5 th
Poaching of staff by other microfinance business	26.7	6 th
Higher salary levels	53.3	4 th
Lack of vehicles for transportation	60	3 rd
Higher communication cost	46.7	5 th
Higher information technology cost	73.3	2 nd
Higher utility cost	60	3 rd
Lack of solid credit risk management policy	53.3	4 th
Lack of adequate client information	80	1 st
Unwillingness of clients to provide personal information	53.3	4 th
Lack of qualified research team	46.7	5 th

The third objective of the study was to examine the major challenges facing microfinance businesses in Madina. The findings were based on the position of Adjei in 2010 concerning challenges facing microfinance businesses in Ghana. For the purpose of this study, only responses with response percentage of 50% and above agreeing to the statements have been used for the discussion. The challenges facing microfinance businesses were as follows:

The topmost challenge facing microfinance institutions is getting adequate client information as indicated by 80% (Table 1) response rate. This could be the reason why the interaction between the businesses and their customers were in the form of face-to-face. Access to customer information is vital to the survival of the business as this will help the business to mostly inform customers about new products and services been offered by MFIs.

The second major challenge facing microfinance institutions was higher cost of information technology with response rate of 73.3%. The 21st century is the age of information technology. As such governments in developing countries like Ghana have made it their target to make good use of information technology. Information technology has made the world a global village and businesses like these microfinance institutions cannot be left out. It is therefore compelling on the government to make it easily accessible and less expensive for these microfinance institutions to also tap into this resource for the achievement of goals.

The third major challenge facing MFIs was in relation to lack of vehicles for transportation and higher utility cost with a 60% response rate respectively. Transportation is a means through which MFIs would be able to move around to mobilize funds from their customers. As it can be observed that most of the interaction that exists between these businesses and their customers are on face-to-face basis, transportation should be very keen in their operation.

Also, these MFIs operate their businesses with use of electricity and other utilities, which form part of the cost component of their financials, when the cost of utility becomes high; there is an automatic drop in profit by the margin of increment. Since businesses operate and expand as a result of plough back of profits into the business, when these profits that could have helped these businesses to grow rather goes into utility cost, it could hamper the growth and sustainability of these MFIs. Unfortunately for these MFIs, recently the government have announce 78.9% and 52% tariff increment in electricity and water

respectively which took effect on 1st October, 2013. This directly will bring further cost to these MFIs.

The fourth position on the challenges log is occupied by three factors with each having a response rate of 53.3%. These are higher salary level, lack of solid credit risk management policy and unwillingness of clients to provide personal information. Lack of solid credit risk management policy, meant that there was no laid down procedure for granting loans and policy on follow ups. This could result in higher loan default rate. However, their current stage of development might be a contributing factor for not having the policy. Again, the unwillingness of customers to provide personal information can be attributed to reasons why the MFIs are having difficulty in gathering adequate information about clients.

Conclusion

Microfinance is perceived as one the tools of dealing with poverty in developing countries like Ghana. In this regard, when microfinance are taken seriously by government, it will help in job creation, serve as source of capital for micro enterprises, contribute to the GDP, etc. the researchers therefore conclude on the following.

The development of microfinance in the Madina area has been for the past five years, with most of the businesses being established through experience. The main aim for establishing these businesses was to provide income to low-income households who operate their own businesses. The microfinance companies in Madina started their businesses with their own personal savings, and subsequently run their microfinance companies through deposits they receive from their customers or clients.

The success factors of microfinance companies in the Madina area are provision of services which were appropriate and consistent with customers' situation and needs, character-based lending, frequent visit of credit officers to customers leading to good interpersonal relationship with customers.

The major challenges facing microfinance institutions in the Madina area are lack of adequate client information, higher information technology cost, lack of vehicle for transportation, higher utility cost, higher salaries, unwillingness of clients to provide personal information and lack of solid credit risk management policy.

Recommendations

Based on the study conducted, the following recommendations are suggested by the researchers:

There is the need for the designing of strong credit risk management policy. In the absence of credit risk management policy, in no time, the microfinance institutions may end up in huge loan default rate.

There is the need for the MFIs to build good database about their customers so as to help them better interact with their customers. To aid tracking and retention of customers.

There is the need for the customers to willingly assist the MFIs by giving required personal information that will help build strong relationship with the businesses.

Government should pay particular attention to the microfinance sector and institute policies that would expand the sector. Most of the microfinance companies are financed through personal savings and deposits from these low-income households; it limits the expansion capacity of microfinance businesses, their ability to employ more people to reduce the national deficit on unemployment

There is the need for further empirical studies to be conducted in other regions or other metropolis since the study was limited to Madina and as such not all factors may have been examined. This will lead to the broadening of knowledge and scope in the area of microfinance operations in Ghana.

References

- Ablorh, W. (2011). Microfinance and socio-economic empowerment of women: A case of Opportunity International Savings and Loans clients. *Kwame Nkrumah University of Science and Technology (Unpublished Master's Dissertation)*, 16-19. Available at <http://dspace.knust.edu.gh:8080/jspui/bitstream/123456789/4196/1/Ablorh%20thesis.pdf>
- Adjei, J. K. (2010). *Microfinance and Poverty Reduction: The experience of Ghana*. Accra: Bold Communications Limited.
- Ananth, B. (2005). Financing microfinance – The ICICI Bank partnership model. *Small Enterprise Development*, 16(1), 57-65. Available at <https://practicalaction.metapress.com/content/860w4w75435755wu/resource-secured/?target=fulltext.pdf>
- Aryeetey, E. (2003). Financing SMEs in Africa. *Policy Insights*, 7, 12.
- Baten, M. W. (2009). Vision of micro financing in Bangladesh: Success and challenges. *Copenhagen Business School (Unpublished Master's thesis)*. Available at <http://studenttheses.cbs.dk/bitstream/handle/10417/796/waliul%5Fbaten.pdf>.
- Crabb, P. (2008). Economic freedom and the success of microfinance institutions. *Journal of Developmental Entrepreneurship*, 13(2), 205–219.
- Dichter, T. (2003). *Despite good intentions: Why development assistance to the third world has failed*. Amherst: University of Massachusetts Press.
- Fehr, D., & Hishigsuren, G. (2006). Raising capital for microfinance: Sources of funding and opportunities for equity financing. *Journal of Developmental Entrepreneurship*, 11(2), 133–143. Available at <http://academicarchive.snhu.edu/bitstream/handle/10474/1657/cfs2004-01.pdf?sequence=1>
- Hempel, G.H. & Simonson, D.G. (1999). *Bank management —Text and cases*. New York, NY: John Wiley & Sons.
- Hubka, A., & Zaidi, R. (2005). *Impact of government regulation on microfinance*. Washington, DC: World Bank. Available at http://siteresources.worldbank.org/INTWDR2005/Resources/Hubka_Zaidi_Impact_of_Government_Regulation.pdf
- Imran, M., Ghani, U., & Iftikhar-ul-Amin. (n.d). Microfinance institutions of the subcontinent: A comparative analysis. *The Dialogue*, IV (4), 507-524.
- Al Mamun, C. A. (2012). Assessing the factors that led to the success of microfinance in *Bangladesh: A case study on Grameen Bank*. *World Review of Business Research*, 1-14
- Microfinance Information Exchange. (2010). available at <http://www.themix.org/about/microfinance>
- Muhammad, S. D. (2010). Microfinance challenges and opportunities in Pakistan. *European Journal of Social Sciences*, 14(1), 94-97. Available at <http://ejournal.narotama.ac.id/files/Microfinance%20Challenges%20and%20Opportunities%20in%20Pakistan.pdf>

- Sriram, M. S. (2005). Information asymmetry and trust: A framework for studying microfinance in India. *VIKALPA*, 30(4), 78. Available at http://www.vikalpa.com/pdf/articles/2005/2005_oct_dec_77_85.pdf
- Wisniwski, S. (1999). *Microsavings compared to other sources of funds*. Hannig, A and S Wisniwski (Eds.), Eschborn: Deutsche Gesellschaft fur Technische Zusammenarbeit (GTZ) GmbH.
- Woller, G., & Woodworth, W. (2001). Microcredit as a grass-roots policy for international development. *Policy Studies Journal*, 29(1), 267–283.