

**PERFORMANCE ASSESSMENT OF
MICROFINANCE INSTITUTIONS IN THE
ASHAIMAN MUNICIPALITY**

BY

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DECLARATION

I hereby declare that this submission is my own work towards the Executive Masters Of Business Administration and that, to the best to my knowledge, it contains no material previously published by another person nor material which has been accepted for the award of any other degree of the University, except where due acknowledgement has been made in the text.

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ABSTRACT

The object of this study is to identify the microfinance institutions operating in the Ashaiman municipality, measure their performance through the use of indicators such as Portfolio Quality, Financial Performance based on their audited accounts to determine return on Equity, Investment, Debt/Equity Ratio, and Return on Assets. For efficient collection of the relevant information, a sample size was selected from the entire population. A simple questionnaire was developed and administered among the sample. In addition to the administering of the questionnaire, there were interviews with key managers of the Rural Banks, Savings and Loans and Credit Unions. Through the study, it was observed that customers that obtained loans from the Savings and Loans company were more than the Rural Bank and the Credit Union, even though their cost of borrowing (from the Savings and Loans) is higher. It was also found that Credit Union have very low recovery rate. It is recommended that since most customers prefer accessing loans from the Savings and Loans, the management of the Savings and Loans reduce their interest rates in order not to 'kill' the smaller businesses since their profit is not so high.

DEDICATION

The work is dedicated to my three sons, Nii, Mas and Josh, for their continued support in diverse ways for me, which has enabled me to aspire to this height.

I trust that they will be inspired by this work, to strive to attain higher levels in whatever fields' nature and nurture will permit them.

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CHAPTER ONE

1.1.BACKGROUND TO THE STUDY

Small enterprises and most of the poor population in sub-Saharan Africa have very limited access to deposit and credit facilities and other financial services provided by formal financial institutions. For example, in Ghana and Tanzania, only about 5–6 percent of the population has access to the banking sector. This lack of access to financial services from the formal financial system is quite striking, when one considers that in many African countries the poor represent the largest share of the population and that the informal sector is an important part of the economy (International Monetary Fund, 2004). This situation in no small measure accounts for the underdevelopment of Africa, Ghana being no exception.

Microfinance perceived as a financially sustainable instrument meant to reach significant number of poor people of which most are not able to access financial services because of the lack of strong retailing financial intermediaries. Access to financial services is imperative for the development of the informal sector and also helps to mop up excess liquidity through savings that can be made available as investment capital for national development (World Bank- Africa Region, 1999). Microfinance as a sector has the ability to reduce poverty by bringing a significant improvement in the lives of the poor.

Without a doubt a well-functioning financial system is the key to economic growth and development because it is the financial sector which controls and directs funds to the various productive sectors of the economy. This accounts for the drive by many developing countries to embark new policy initiatives to reform the financial sector

There are various schools of thought on the impact of microfinance on poverty reduction and economic development. Generally, microfinance encompasses the provision of financial services and the management of small amounts of money through a range of products and a system of intermediary functions that are targeted at low income clients (United Nations, 2005). It includes loans, savings, insurance, transfer services and other financial products and services. According to the United Nations (2000) microcredit is thus one of the critical dimensions of the broad range of financial tools for the poor, and its increasing role in development has emanated from a number of key factors that include:

- The fact that the poor need access to productive resources, with financial services being a key resource, if they are to be able to improve their conditions of life
- The realization that the poor have the capacity to use loans effectively for income-generation, to save and re-pay loans
- The observation that the formal financial sector has provided very little or no services to low-income people, creating a high demand for credit and savings services amongst the poor
- The view that microfinance is viable and can become sustainable and achieve full cost recovery
- The recognition that microfinance can have significant impact on cross cutting issues such as women's empowerment, reducing the spread of HIV/AIDS and environmental degradation as well as improving social indicators such as education, housing and health.

Indeed, empirical studies have shown that micro-finance helps very poor households to meet basic needs and protects against risks, and is thus associated with

improvements in household economic welfare. Gender activists also argue that microfinance helps in empowering women by supporting women's economic participation and so promotes gender equity (Bank of Ghana, 2007)

In the view of Simanowitz and Brody (2004),” micro-credit is a key strategy in reaching the Millennium Development Goals (MDGs) and in building global financial systems that meet the needs of the poorest people.” Other schools of thought suggest that “micro-finance creates access to productive capital for the poor, which together with human capital, addressed through education and training, and social capital, achieved through local organization building, enables people to move out of poverty” (Bank of Ghana,2007). By providing material capital to a poor person, their sense of dignity is strengthened and this can help to empower the person to participate in the economy and society (Otero, 1999).

In the opinion of Littlefield, Murdoch and Hashemi (2003), “...micro-credit is a critical contextual factor with strong impact on the achievements of the Millennium Development Goals. Micro-credit is unique among development interventions: it can deliver social benefits on an ongoing, permanent basis and on a large scale”

The aim of micro-finance according to Otero (1999) is not just about providing capital to the poor to combat poverty on an individual level, it also has a role at an institutional level. It seeks to create institutions that deliver financial services to the poor, who are continuously ignored by the formal banking sector. Littlefield and Rosenberg (2004) argue that the poor are generally excluded from the financial services sector of the economy so MFIs have emerged to address this market failure (Bank of Ghana, 2007). By addressing this gap in the market in a financially sustainable manner, an MFI can become part of the formal financial

system of a country and so can access capital markets to fund their lending portfolios, allowing them to dramatically increase the number of poor people they can reach (Otero, 1999).

However, some schools of thought remain skeptical about the role of micro-credit in development (Bank of Ghana, 2007).

For example Hulme and Mosley (1996) contend that "...most contemporary schemes are less effective than they might be" (1996, p.134). The authors argued that micro-credit is not a panacea for poverty-alleviation and that in some cases the poorest people have been made worse-off.

The structure of the financial systems of the economies of the world, Ghana being no exception comprises both the formal and informal sectors. Microfinance has been defined as the provision of financial services and the management of small amounts of money through a range of products and a system of intermediary functions that are targeted at low income clients, falls under the informal financial sector. It is estimated that only one percent (1%) of the same people ever received a formal bank loan. In spite of the fact that poor people who mostly live in rural areas constitute the vast majority of the population in most developing countries, and for that matter Ghana, formal financial institutions are mostly urban centred.

Clearly, there is broad consensus among academia and policy makers that although microfinance is not a panacea for poverty reduction and its related development challenges, when properly harnessed it can indeed make sustainable contributions through financial investment leading to the empowerment of people, which in turn promotes confidence and self-esteem, particularly for women (Bank of Ghana, 2007). The unique role of MFIs in the development of any economy especially a developing one calls for proper monitoring to ensure their efficiency and

sustainability so that they can serve as pillars of change to create a better life for the poor and vulnerable.

Microfinance in Ghana has improved tremendously in numbers, coverage, poverty alleviation, services delivery, job creation, capacity building and technology transfer just to mention few over the last decade. For example, trends in loans and advances extended to small businesses, individuals and groups by the Non-Bank Financial Institutions (NBFIs) in Ghana amounted to GH¢50.97 million in 2002 as against GH¢39.64 million in 2001, indicating about 28.6 per cent growth. The amount of loans extended by NBFIs further increased from GH¢70.63 million in 2003 to GH¢72.85 million in 2004, suggesting 3.1 per cent growth. In 2006 alone, total of GH¢160.47 million was extended to clients, which represents 48.8 per cent higher than the previous year's total loans and advances granted by these microfinance institutions. The upward-trending NBFIs' credit to individuals, small businesses, groups and others indicates marked improvements in level of microfinance in the country (Bank of Ghana Working Paper, 2007).

Providing microfinance services without building the capacities of the beneficiaries could sometime be dangerous since the intended objective for which the loans were given may not be achieved. Some microfinance institutions like ProCredit Savings and Loans provided entrepreneurial training programs for their customers. In 2006 ProCredit sought to promote women in business by offering the female entrepreneurs a series of seminars on sound business strategies and financial management (ProCredit Annual Report, 2006).

Despite the numerous achievements made by the microfinance service providers, employees and recipients of the services, there has been some setbacks which made the sector unstable, least trusted and unattractive in the early 1990s such

as the frequent scam where depositors moneys were taken away, ineffective monitoring of the operators by the central bank; this situation lead to many mushroom microfinance companies springing up and dying out at tender stages therefore collapsing smaller businesses.

In recent years, the criticism has also been centered on the very high interest rates charged by most microfinance services providers. This has caused the collapse of some small scale business therefore not serving the purpose for which it was intended to achieve (poverty alleviation). Borrowers then become over burden with payment of loan or interest.

1.2.STATEMENT OF THE PROBLEM

Performance measurement is important in terms of deposit mobilizing institutions such as banks and microfinance institutions. Performance management ensures that stakeholders are able to make informed choices. For institutions to be transparent and more efficient and sustainable, they need to report to the stakeholders who have interest in the organizational performance.

However, it is hard to achieve transparency if there is no proper agreement on how indicators measuring financial condition, risk and performance should be named and calculated. It is therefore important that certain performance measurement indicators are used to measure the performance of microfinance institutions periodically to ensure their sustainability.

Today, there are a growing number of MFI in Ghana. Of serious concern to many stakeholders is the sustainability of this increasing number of MFI. The fourth principle of microfinance, as outlined by Consultative Group to Assist the Poor (CGAP) at G8 summit (2004), states that 'financial sustainability is necessary to reach significant numbers of poor people'. A successful MFI must therefore extend

its coverage to large number of clients and become financially self-sufficient. Not only must MFIs reach out to large number of poor people but they must also be able to fully cover its costs; operational cost as well as the cost of its funds (including the cost of borrowing from banks and the cost of inflation) from its interest and fees.

It appears that, standardized performance indicators such as Portfolio at Risk (PaR), Write-off Ratio, Operating Expenses ratio, and others are used to assess the performance of these institutions to ascertain whether they are performing better or not; are all the MFI in the Municipality duly licensed by BOG to perform as micro finance institutions? What are the causes of the influx of MFI in the Ashaiman municipality? Are they making profit? Is their mode of loan recovery successful? It is against these backgrounds that the researcher wishes to study 'The performance of Micro Finance Institutions in the Ashaiman municipality'.

1.3.OBJECTIVES OF THE STUDY

The main objective of this research is to assess the financial performance of microfinance institutions (MFI's) in Ghana with emphasis on the Ashaiman municipality of Greater Accra Region. The specific objectives are to:

- To find out the motivation for the influx of MFIs in the municipality;
- To find out if the MFIs in the municipality are living up to expectations;
- To ascertain the productivity of the MFIs in the municipality;

1.4.RESEARCH OBJECTIVES

- What are the motives for the influx of the MFIs in the municipality?
- Are the MFIs in the municipality living up to standards?
- Are the MFIs in the municipality productive?

1.5.SIGNIFICANCE OF THE STUDY

Amongst other things, this study is meant to:

- Be an essential requirement for the award of a Master of Business Administration degree from the Kwame Nkrumah University of Science and Technology.
- Draw the attention of government and other development partners to the performance of informal financial sector, especially MFIs.
- Draw the attention of MFIs in general and Dangme Rural Bank, Dzadikuma Credit Union and Pro Credit in especially to their performance from 2007 to 2010.
- The study also serves as a useful guide, source of knowledge and reference material for students, stakeholders, development partners and policy makers.
- Recommend to the MFIs appropriate policy measures that will help them to improve on their performance.
- Serve as a useful literature for others who want to work in this field of study.

1.6.THE SCOPE OF THE STUDY

This study is centred on the evaluation of financial performance of MFIs in the country from 2007 to 2010 financial years. However the study has been restricted to the Ga-Adangme Rural Bank, Dzadikuma Credit Union and Pro Credit Savings and Loan. These institutions have been selected for the simple reason that even though they are operating in this area, poverty still remains a dominant syndrome in this area. Again the researcher selected Ashaiman because:

- First, it was realized that not much research has been conducted on the performance of MFI's operating in the Ashaiman municipality.
- Second, the types of economic activities prevalent in the municipality – most of the people are engaged in small scale businesses such as commerce (trading), dressmakers, hairdressing, and mechanics among others. These and other factors aroused the interest of the researcher and hence the need to assess the financial performance of the MFI's in the Ashaiman municipality.
- Third, the increasing number of MFI's in the municipality.

The indicators to be used are financial indicators which include Portfolio at Risk (PaR), Provision Expense ratio, Write off ratio, Debt or Equity ratio, Returns on Assets, and Equity ratio. The methods of data analysis will include trend analysis – used to analyze the behaviour of some of these indicators, financial ratios within the period under study.

1.7.LIMITATIONS OF THE STUDY

Even though the study was successful, there were some limitations;

- The three institutions which were used as the sample size may not reflect the true activities of the MFIs in the Municipality.
- The research focused solely on financial assessment.
- Using one municipality for study may not be a good representation of MFIs in the Greater Accra Region.

1.8.ORGANIZATION OF THE STUDY

This work is organized into five chapters. The introduction of the work which consists of the background of the study, statement of problem, objectives of the study, significance of the study, the organization of the study and definitions of terms

Chapter two covers the literature review. In this the relevant literature to the study is thoroughly reviewed and the areas considered include theoretical issues in financial sector reform, microfinance and relevant concepts, justification of microfinance, products and impacts of MFIs, microfinance revolution, microfinance in Ghana, performance of MFIs, and criticisms of microfinance.

In chapter three, the methodology used for the study is considered. This embraces the choice of the study area, population and sampling, data collection procedures, research instruments, research design, data analyses, putting the indicators into context, calculating the financial ratios and the limitations of the research. The discussion and presentation of result is captured in chapter four. Chapter five consists of the summary of findings, recommendations and conclusions.

1.9.DEFINITION OF CONCEPTS

Microfinance institutions: These are financial institutions that provide small financial services to the low income people, usually to help support self-employment.

Active borrowers: Clients who have at least one current outstanding loan with the institution.

Active savers: Total number of clients who currently have funds on deposit with MFI which the MFI is liable to repay.

Poverty: A pronounced deprivation which encompasses wide range of issues including hunger, lack of shelter and clothing, lack of access to health care and education and inadequate or lack of access to policy making. (UNDP, 1999; 2001)

Portfolio: This is the combination of shares or other investments that an individual or a company has.

Performance indicators: This is a measurement of value that gives an idea of how successful or how well the MFIs are performing.

Sustainability: This is the ability of microfinance provider to cover all its costs so that it remains in operation to the provision of financial services to the poor.

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CHAPTER TWO

LITERATURE REVIEW

2.1.INTRODUCTION

This chapter explores financial sector reforms from the view point of theories. As with most developing countries that have pursued economic and structural reforms, Ghana has undergone a process of financial sector restructuring and transformation as an integral part of a comprehensive financial sector liberalization programme. Ghana's financial sector liberalization programme began in the early 1990s as part of a comprehensive macroeconomic adjustment programme to strengthen the economy.

2.2.THEORETICAL ISSUES IN FINANCIAL SECTOR REFORM

Literature clearly suggests a strong positive relationship between financial sector development and savings mobilization. In the early works of McKinnon (1973) and Shaw (1973), they argue that the liberalization of interest rates would end financial repression and cause financial deepening due to the resulting increased efficiency of the intermediation process, and the effects of higher interest rates on savings. McKinnon and Shaw (1973) contends that the financial markets in the developing countries are repressed as a result of the setoff policies that often take the form of various administrative controls and distort the domestic financial market. Some of the widely used instrument of financial repression are ceilings on interest rates and credit, high reserve requirements, foreign exchange controls etc. The adverse effects of financial repression are further aggravated by inflation.

The major argument of the financial repression hypothesis is that repression is mainly attributed to government intervention and quantity rationing devices such as the use of selective credit policies to maintain low interest rates in situations of high

inflation. In the view of McKinnon and Shaw, the salient feature of a financially repressed economy is the interest rate control. The objective of a low interest rate policy is to encourage investment particularly in the so-called priority sectors of the economy. This is done directly by setting a ceiling on loan rates, or indirectly, through ceilings on deposit rate, because banks which option funds cheaply will be able to lend cheaply. But the real cost of the low interest policy is high. Interest rates control creates a distortion in the financial market by creating a gap between the demand and the supply of funds available for loans and creates incentives from non-productive inflation hedges such as gold, jewellery, real estate and commodities. This causes a decline in money saving and therefore, in funds available for investment (Syed and Kabir, 1996).

McKinnon (1973) suggests that establishing a positive real interest rate will lead to a higher rate of investment. Potential investors depend on own finance in the absences of organized financial market and must accumulate adequate money balance prior to their investment. High real deposit makes the process of accumulation of money balance and physical capital complementary (Syed and Kabir, 1996). The difference between the hypotheses of these two authors is in the transmission mechanisms through which they believe this process would occur.

Similarly, Mavrotas and Santillana (1999) present the theoretical links between financial sector liberalization and savings mobilization based on the life-cycle or permanent income theory of consumption. They argue that financial liberalization increases competition between providers of financial intermediation, thereby eliminating the constraint on borrowing. This means that the young can now borrow in order to attain their optimal lifetime consumption path.

In a related study, Kelly and Mavrotas (2003) use panel integration and co integration tests for a dynamic heterogeneous panel of 17 African countries to examine the impact of financial sector development on private savings. The empirical results obtained vary considerably among the countries in the panel, thus highlighting the importance of using different measures of financial sector development rather than a single indicator.

Other studies have also examined the link between financial sector development, economic growth and poverty reduction in order to identify clearly the channels through which financial sector development can influence economic growth. Theorists can be subdivided into two broad schools of thought: (i) the Structuralists, and (ii) the Repressionists. The Structuralists contend that the quantity and composition of financial variables induce economic growth by directly increasing savings in the form of financial assets, thus encouraging the capital formation that leads to economic growth and consequently poverty reduction. The financial Repressionists, led by McKinnon (1973) and Shaw (1973)-often referred to as the 'McKinnon-Shaw' hypothesis-contend that financial liberalization in the form of an appropriate rate of return on real cash balances is a vehicle for promoting economic growth. The essential tenet of this hypothesis is that a low or negative real interest rate will discourage savings. This will reduce the funds available for investment which, in turn, will lower the rate of economic growth. Thus, the McKinnon-Shaw model posits that a more liberalized financial system will increase competition, increase interest rates and induce an increase in savings and investment and consequently promote economic growth.

Empirical studies have also established the relationship between financial sector development and economic growth. Jung (1986) finds a bi-directional

causality between financial and real variables in post-war data for 56 countries, 19 of which are developed industrial Economies. Wachtel and Rousseau (1995) also find that financial sector development Granger-causes economic growth.

Similarly, Jalilian and Kirkpatrick (2001) examine the link between financial development and poverty reduction by using data for a sample of 26 countries, including 18 developing countries. They use bank deposit money assets and net foreign assets as measures of financial development. Their results suggest that a 1 per cent change in financial development raises growth in the incomes of the poor in developing countries by almost 0.4 per cent. Financial development can also have an indirect impact on the living standards of the poor through its support of economic growth (World Bank 2001: The relationship between growth and poverty has been the focus of considerable attention in recent years (Squire 1999; World Bank 2001; Ravallion 2001). A World Bank study (2001b: 52) explains that any given growth scenario can generate different poverty outcomes—for a given rate of growth, the extent of poverty reduction depends on how the distribution of income changes with changes in growth, and on initial inequalities in income, assets and access to opportunities to allow the poor to share in growth. Equi-proportional growth leaves income distribution intact, whereas by improving the position of some at the lower scale of distribution, it reduces poverty. Pro-poor growth, however, will by definition improve the status of the poor and affect income distribution.

Moreover, studies have shown that financial sector development can lead to poverty reduction and can also affect inequality. For instance, Goudie and Ladd (1999) and McKay (2002) argue that although growth will benefit the non-poor in the society, at the same time it will improve income distribution.

2.3.MICROFINANCE

Microfinance in one form or another has existed for centuries. Throughout history, people in need of financial services, who lack the opportunity or ability to enter the formal financial markets, have designed micro saving and microcredit programs without the intervention of outside institutions or agencies. It has only been in the last four decades however, that serious efforts have been made to formalize these processes and services through the creation of microfinance institutions. A brief overview of modern microfinance industry is thus;

“Microfinance” is often defined as financial services for poor and low-income clients. In practice, the term is often used more narrowly to refer to loans and other services from providers that identify themselves as “Micro-Finance Institutions” (MFIs). These institutions commonly tend to use new methods developed over the last 30 years to deliver very small loans to unsalaried borrowers, taking little or no collateral. These methods include group lending and liability, pre-loan savings requirements, gradually increasing loan sizes, and an implicit guarantee of ready access to future loans if present loans are repaid fully and promptly.

More broadly, microfinance refers to a movement that envisions a world in which low-income households have permanent access to a range of high quality financial services to finance their income-producing activities, build assets, stabilize consumption, and protect against risks. These services are not limited to credit, but include savings, insurance, and money transfers.

Marguerite(2001), defines micro-finance as small-scale financial services (primarily credit and savings) provided to people who farm or fish or herd; who operate small enterprise 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.

Microfinance refers to financial services provided to low-income people, usually to help support self-employment. Examples of microfinance products include small loans, savings plans, insurance, payment transfers, and other services that are provided in small increments that low-income individuals can afford (Smith, 2002).

It must be emphasized that microfinance is not limited to the rural folks as it is been thought of. Today, microfinance activities are all over the urban cities in Africa, Asia and even Europe and America. Traditional banks are today into microfinance in the cities of Africa. For example, in Ghana alone, there are microfinance activities going on in all the regional capital, more especially in Accra, the national capital.

Steel and Anda (2003) define microfinance as “small financial transactions with low income households and micro enterprises both urban and rural, using non-standardized methodologies like character-based lending, group guarantees and short-term repeat loans”

Microfinance is the supply of loans, savings, money transfers, insurance, and other financial services to low-income people. Microfinance institutions which encompass a wide range of providers that vary in legal structure, mission, and methodology, offer these financial services to clients who do not have access to mainstream banks or other formal financial service providers. Consultative Group to Assist the Poor (CGAP, 2005) also defined microfinance as the supply of loans, savings and other basic financial services to the poor.

In other words we can also say that microfinance is a term for the practice of providing financial services, such as micro credit, micro savings or micro insurance, money transfer and micro leasing. By helping the poor to accumulate large sums of money, this expands their choices and reduces the risks they face. Suggested by the name, most transactions involve small amounts of money, frequently less than US\$100.00

2.4.THEORIES, APPROACHES, AND CONCEPTS

2.4.1. Supply-Leading Finance Theory

Supply-leading finance is the provision of loans in advance of the demand for credit for the purpose of inducing economic growth (Mauguerite, 2001).

Marguerite, (2001) and Patrick, (1983) defined supply leading finance as the creation of financial institutions and instruments in advance of demand for them in an effort to stimulate growth. Thus this strategy seeks to make the allocation of capital more efficient and to provide motivation for growth through the financial system. The strategy is more pertinent to seasonal economic activities such as farming.

The assumption of the supply-leading finance theorists is that economic growth in rural areas could be encouraged through the financial system. Therefore, financial incentives for the adoption of new agricultural technologies, often in the form of subsidized credit, were provided to farmers in advance of the demand for them.

This was done base on their belief that the savings of most of the farmers was not enough for the inputs they required and could not pay the commercial cost of credit. Farmers need much more capital than they can afford to save (Marguerite, 2001; Lewis 1995). According to Vogel (1984), savings was the “forgotten half of

rural finance”, because of the assumption that there were little or no savings to be mobilized in the rural areas of developing countries.

2.4.2. Financial System Approach Verses Poverty Lending Approach

The economically active poor of the world continuously small scale commercial financial services. According to Schuler (1994), there is what is called “absurd gap” between supply and demand in microfinance. This has resulted from the inability of the formal financial sector to satisfactorily meet the demand for credit. The two leading views on how to fill the absurd gap are explained below.

The Financial System Approach: This approach places more emphasis on large-scale outreach to borrowers who can repay micro-loans from household and enterprise income streams - the economically active poor. It focuses on institutional self-sufficiency because, given the scale of the demand for microfinance worldwide, this is the only promising means of meeting widespread client demand for convenient, appropriate financial services. The approach seeks to deal with commercial financial intermediation among poor borrowers and savers. These intermediaries not only grant loans and voluntary savings services to the economically active poor, but also offer easy access at reasonable cost. Their loan portfolios are financed by savings, commercial debt, and for-profit investment in varying combinations. These institutions have been able to attain wide outreach profitably, and they represent a globally affordable model.

However, commercial microfinance may not be suitable for the extremely poor who are badly malnourished, ill, and without skill nor employment opportunities, as these starving borrowers will use their loans to feed themselves or their children.

The Poverty Lending Approach: This approach emphasized poverty reduction through credit and other non-financial services (such as skills training, and the teaching of literacy and numeric, health, nutrition, family planning and the like) provided by institutions that are funded by donors and government subsidies and other concessionary funds. Thus the emphasis is on micro-credit and not microfinance. Savings is an insignificant part of the poverty lending approach except for the obligatory savings required as a condition for receiving a loan. Some institutions using this approach provide micro-credit to poor borrowers at low cost.

Since the interest rates on these loans are too low, these institutions, more often than not, cannot cover all their costs. As a result, these institutions are not sustainable. The institutions cannot meet nor quench the ‘thirst’ of the poor for financial services. Rhyne (1998), points out that, “Everyone involved in microfinance shares a basic goal; to provide credit and savings services to thousands or millions of poor people in a sustainable way”. By this she is indicating that the debate is not just about the goals but the means, and that the means can limit the goals that can be achieved.

Having considered the two approaches above, it is clear that each of them have a different point of focus. While the financial system approach focuses on the institutions financial self-sufficiency the poverty lending approach focuses on provision of financial services funded by donor and government support as well as concessionary funds. Thus, savings is not a requirement for loan application but the financial system approach insists on savings.

2.4.3. Institutionist Approach verses Welfarist Approach

With regards the bestway of helping the poor through access to financial services, there are two approaches; the Institutionist and the Welfarist approaches. Morduch. (1998) terms this division as *microfinance schism*.

The Institutionist School: The principal aim of microfinance, according to the Institutionist is financial deepening. That is, the setting up of a separate system of “sustainable” financial intermediation for the poor who are either neglected or are underserved by the formal financial system. The activists of this school of thought emphasized more on the achievement of financial self-sufficiency, breadth of outreach (numbers of clients), depth of outreach (levels of poverty reached) and positive client impact. The interest of the approach is that the institutions refrain from all kinds of subsidies as they insist on financial self-sufficiency.

The Welfarist School: to the welfarist school, self-employment of the poorer of the economically active poor, especially women is their prime objective. Their interest lie in the “family” and they lay more emphasis on the depth of outreach (the levels of poverty reached). The welfarist is more concerned with the use of financial services to minimize the effects of acute poverty among individual participants as well as communities. The focus of this school of thought is on the abrupt improvement in the well-being of participants.

Though there are significant lines of differences between the two schools of thought, they have some similarities as well. In as much as the two approaches seek to solve the problem of financial needs of the poor, microfinance activities should aim at achieving the objectives of the two approaches.

2.4.4. Microfinance and Government Relationship Concept

Even though most economists including Adam Smith have criticized the role governments, as far as the development of their economies are concerned, the role of government cannot be underestimated. Governments play multiple roles, including accumulating capital, planning investment, promoting industrial development and agricultural growth, developing infrastructure among others. The intervention by donors and governments in rural finance markets was considered essential. This is explained by the fact that, as profit maximizing entities, private lending institutions characteristically do not engage in most types of rural lending due to the conviction that few rural households would be willing or able to pay commercial interest rates, and that the sustainability of their institutions cannot be assured.

Moreover, government intervention in rural credit markets has been advocated for the simple reason that it is easier for policy makers to implement such policies. It was supposed that subsidized credit to farmers would offset urban bias, improving income distribution and reducing regional disparities.

However, Penny (1983) notes that supply-leading subsidized credit programmes are ineffective in stimulating agricultural growth and typically have poor returns. Gonzalez-Vega (1976) also holds that when interest rates are subsidized, rent-seeking behaviour by borrowers, combined with the relatively high costs to lenders of small loans, ensures that institutional loans are routinely channelled to larger borrowers. He implied that large-scale subsidized programmes generally do not reach low-income households. World Bank (1984) also points out that subsidized credit programmes, especially in state-owned institutions, often have high default rates.

2.5.JUSTIFYING MICROFINANCE

The use of microfinance as a major strategy for poverty reduction in developing countries, which includes Ghana, is increasingly being perceived as an effective tool for rural poverty reduction among the development community. This perception has catalyzed much support for the increase of resources to the microfinance industry. According to Morduch (2000), few recent innovations have held so much hope for reducing poverty in developing countries as microfinance. Indeed, microfinance has become one of the crucial driving mechanisms towards achieving the Millennium Development Goals (MDGs), especially concerning the target of halving extreme poverty and hunger by 2015 (Fernando, 2004). According to leading advocates in the field, microfinance has the capacity not only to reduce poverty, but to develop the institutional capacity of microfinance institutions to efficiently and effectively provide sustainable financial services to poor households who are otherwise excluded from the formal banking system for lack of collateral. Evidently, microfinance has become one of the most important interventions for reducing rural poverty in developing countries.

The extent of poverty and the importance of the rural sector to the economy make it pivotal for microfinance interventions. Poverty in Ghana, like in most other sub-Saharan African countries, is predominantly a rural phenomenon. Out of 35% of Ghanaians classified as poor, 75% lived in the rural areas (World Bank, 1995). Rural poverty is estimated to contribute approximately 90% to national poverty (Oduro, 2001). More than one-half of the population living in the rural Savannah regions of Ghana continues to be extremely poor. Poverty is highest among self-employed households cultivating agricultural crops and has decreased only slightly compared to self-employed households engaged in export-crop agriculture and wage employees in

the public and private sectors. In spite of these, agriculture, which is mainly rural-based and the core of the Ghanaian economy, remains the principal sector for the development and growth of the economy. The importance of the rural sector to the economy and the extent of poverty in this sector make the application of microfinance interventions essential.

In recent times, microfinance has become more important as a result of the adoption of structural adjustment programme in many developing countries. The decline in public spending has culminated in the introduction of user fees and cost recovery in most public service delivery. Increasing incomes of the rural poor sustainably through microfinance intervention is an appropriate means of ensuring the poor can access services like education, health and other social services. Another important contribution of microfinance has to do with its ability to enable the poor actively participate in activities that culminate in the improvement of their lives.

2.6.MICROFINANCE INSTITUTION PRODUCTS AND SERVICES

MFIs provide similar products and services to their customers as formal sector financial institutions provide. The scale and method of delivery differ, but the fundamental services of savings programs, extending loans, and offering insurance are the same. By far, extending loans (microcredit) is the dominant product of MFIs thus far (Nourse, 2001). The original attempts to formalize microfinance were almost entirely microcredit programs. Since these early microcredit programs, some MFIs have begun to offer additional products such as savings, insurance, education, and equity services. Nourse (2001) reviews the context and rise of microfinance products and argues there is a need for savings and insurance services for the poor and not just credit products. He goes on to argue that MFIs need to provide tailored lending services for the poor instead of rigid loan products. Supporting this latter assertion of

Nourse (2001), Eyiah (2001) develops a model of small construction management contractors and MFIs in developing countries that provides a tailored lending structure for microenterprise contractors.

The need for microcredit is evidenced in developing countries by the existence of moneylenders. Oftentimes, moneylenders are thought of as loan sharks, providing credit only under the conditions of exorbitant interest rates and fear of collection procedures. Although this is the case in some instances, moneylenders generally provide a valuable financial service for poor people who do not have access to formal credit markets. This service is exemplified in Perry (2002) who presents the case of women moneylenders in Senegal who use village banking borrowings to finance their own money lending businesses. Ismail and Ahmad (1997) provide additional evidence that credit is demanded by people without access to formal financial services by discussing the role of pawnshop lending in Malaysia. He reports that Malaysian pawnshops have increased as lending institutions and are projected to continue to do so due to more affordable transportation, interest rate regulations, and financial liberation, among other factors.

Microcredit is most often extended without traditional collateral. If physical collateral is a requirement for borrowing, most MFI clientele would be unable to participate due to their extreme poverty level. Because borrowers do not have physical capital, MFIs focus on using social capital as collateral. Social collateral is essentially the reputation effect of the borrower and her family. In the village banking and Grameen-type systems, funds are lent to groups, who disperse these funds among the group members (usually neighbours). If group members are to maintain their social standing in the community, they must repay their portion of the loan. Because group members value their social capital, MFIs very effectively use it as collateral

(Woolcock, 2001). Goldmark (2001) suggests methods that may help build social collateral, thereby making loans even more secure.

Along with the lending function, a market for savings exists in poor areas around the world. Gosh and Somolekae (1996), in an article that analyzes whether microfinance can serve as a catalyst or seedbed for industrialization in Botswana identify savings products as one of the key mechanisms needed to promote development. An entire issue (Volume 12, Number 3, 2001) of *Small Enterprise Development* is dedicated to the issue of micro savings. Topics include the mobilization of various sized savings, the introduction of savings services into an existing MFI, the relative risk to the savings of the poor, the need for flexibility in micro savings instruments, and the tailoring of savings vehicles.

Although formally, micro insurance is in the early stages of development, efforts are being made to formalize and design the process. An entire issue (Volume 12, Number 1, 2001) of *Small Enterprise Development* is also dedicated to the topic of micro insurance. Articles highlight the risks and opportunities of micro insurance in general, healthcare micro insurance, funeral micro insurance, agricultural micro insurance schemes, and client selection by MFIs. Two other services analyzed in the existing literature are the use of equity and education as MFI services. Pretes (2002) discusses several cases in East Africa where equity (grants) are used in lieu of microcredit for business formation start-up capital. Pretes titles this MFI service equity; however, in finance parlance these services would most likely be considered grants. Pretes argues that those who invest (donate) the equity receive their returns intrinsically as they do not receive a financial ownership position in the start-up firm (microenterprise).

Addressing MFI education services, Smith (2002) compares MFIs in Ecuador and Honduras that provide either microcredit in isolation or microcredit in conjunction with health education training. He finds that programs that incorporate health care education along with the credit services result in improved health for borrowers and their families; however, programs that only provide credit services do not realize the increase in family health. Edgcomb (2002), Cook et al. (2001), and Dumas (2001) all use case methodology to analyse the MFI service of microenterprise education and conclude that this service significantly improves microenterprise performance and micro entrepreneur empowerment.

2.7.IMPACT OF MICROFINANCE INSTITUTIONS

In this section of reviewing the existing literature, we discuss attempts to assess the impact of MFI services on individuals and communities. We begin this section by discussing the work of Hulme (2000) who reviews the methodological options for the impact assessment of MFI services. Hulme examines the scientific method, humanities tradition, and participatory learning and action models. He concludes that an optimal impact assessment mechanism should be a mix of the different methods for a fit between assessment objectives, program context, human resources, and timing. Hyman and Dearden (1998) also consider the issue of optimal impact assessment methods by reviewing and comparing four MFI evaluation systems.

MFIs as a general rule have both financial and social responsibilities, unlike the typical formal financial institutions which work solely toward a financial responsibility. Microfinance however takes a cue from the financial accounting and performance standards in the formal financial sector. Concepts such as operating expenses ratio, portfolio at risk, retention rate and the like are to a larger extent being

used by the microfinance industry. In practice, it is difficult to lay a finger on and measure the specific impacts of microfinance. Impact assessments requires adoption of research methods capable of isolating specific effects out of a web of causal and mediating factors as well as attaching specific units of measurement to tangible and intangible impacts that may or may not lend themselves to precise definition or measurement. MFIs do not attempt to assess social impact due to the difficulty and cost involved in this assessment; however, policy makers and donors have a legitimate interest in assessing the social returns or benefits to their social investments. Some knowledge of social impacts is therefore essential for the management of MFIs and other stakeholders to assess overall programme performance of effectiveness (Thus, information on financial performance alone gives an incomplete picture of the programme performance)

Interest in the social impact of microfinance has led to a number of impact studies published in scholarly journals, some of which assess microfinance programmes in Bangladesh. Mckernen (1996) finds that programme participation can have a large positive impact on self – employment profits, while Pitt and Khandker (1998) find that programme credit has a significant impact on the well – being of poor households and that this impacts is greater when credit is targeted towards women. Other studies; Schuler and Hashemi (1994), Hashemi and Riley (1996), Schuler et al (1997, 1998), Steel et al (2001) and others focus on the question of female empowerment. Most of these found evidence that microfinance programme participation exerts a statistically significant impact on one or more aspect of female empowerment, such as contraceptive usage or intra-household decision making. Goetz Gupta (1996), however found that significant portions of the women’s loans were controlled by male relatives, thereby limiting the former’s ability to develop

meaningful control over their investment activities; therefore to them, there is no significant impact of MFI programmes on the well-being of women. The findings vary considerably from study to study, indicating that impacts are based on what prevails under a particular circumstance. (Thus, impacts are highly contextually specific).

Analysing other programmes in Bolivia, Bolnick and Nelson (1990) find that MFI participation had a positive impact on enterprises that were typically small, labour intensive and growing, although the impact was far from uniform across sectors and target variables. Copestake et al (2001) find that borrowers who were able to obtain two loans experienced high growth in profits and household income compared to a control sample, but borrowers who never qualified for the second loan were actually worse off due to MFI collection mechanisms. Wydick (1999) finds that upward class structure mobility increases significantly with access to credit. Using the same data set in a subsequent study (2002), Wydick also finds that rapid gains in job creation after initial credit access were followed by prolonged periods of stagnant job creation. Dunn (2001) finds that program clients' enterprises performed better than non- clients enterprises in terms of profits, fixed assets, and employment. Finally, Anderson et al (2002) analysed 147 MFIs and finds that microfinance participation increased environmental awareness and common pool resource stewardship.

Other impact studies address trade-offs that need to be considered when performing microfinance impact assessments. Mosely and Hulme (1998) studied 13 MFIs in seven countries and constructed an 'impact frontier' describing the inverse relationship they find between outreach (depth of poverty reached) and development impact. Wydick (1999b) construct a theoretical model to analyze the economic trade-

off between future returns to schooling and the current return to child labour in Guatemalan household enterprises. He finds that in some states, microcredit increases that probability that children will attend school. On the other hand, during certain state of moral hazard, the cost of schooling may outweigh the benefits of child labour. Kevane and Wydick (2001) find that targeting microenterprise credit to poor women appears to imply a trade-off between economic growth in favour of poverty reduction and child welfare. Particularly, female entrepreneurs of child bearing age create significantly fewer jobs than male entrepreneurs. Most of the impact assessment studies cited above provide evidence of positive impacts of microfinance.

On the contrary, other impact assessment studies fail to find significant impacts. Hulme (2000) reviews the methodological options for doing impact assessment identifying three broad approaches, the scientific method, the humanities tradition, and the participatory learning and action. He concludes that an optimal impact assessment mechanism should be a mix of the different methods for a fit between assessment objectives, programme context, human resources, and timing. Hyman (1998) also considers the issue of optimal impact assessment methods by reviewing and comparing four MFI evaluation systems. Through his analyses, he suggests improved methods for existing assessment approaches. Woller et al (1996b) surveys 73 MFIs in the US and developing countries on their impact evaluation practices. The survey findings shed light on impediments to performing impact assessments on the role played by various stakeholders in the evaluation process. Schreiner (2002) criticizes impact assessments of US microenterprise development programmes for methodological failures such as biased sampling and failure to perform a true cost-benefit analysis.

Many of such criticisms are true for assessment of microfinance programmes in the developing world. The literature above reveals to a larger extent the effectiveness of MFI programmes in diverse sectors of an economy; and to a lesser extent, their impediments. The purpose of this study is therefore to find out whether MFIs perform the way they should do.

2.8.EMPIRICAL LITERATURE REVIEW

The microfinance institutions participation in several developing economies is escalating from time to time. Various studies on different countries on the performance of the MFIs confirm this (Adongo and Stork 2005, Zeller and Meyer 2002, Meyer 2002, Robert cull et al. 2007). For example, in Bangladesh a microfinance institution called Grameen Bank at the end of 2000 reported 2.4 million members, where 95 percent of them are women, with \$225 million outstanding loan. In addition, Thailand also has reported impressive outreach through agricultural lending by the Bank for Agriculture and Agricultural Cooperative (Meyer 2002). In general, a lot number of microfinance institutions have registered impressive outreach in several developing economies including India, Cambodia, and others (Meyer 2002).

A survey by Robert Cull and others on the performance of leading MFIs in 49 countries finds interesting results. It founds that over half of surveyed MFIs are profitable after making adjustment of subsidies. It also identified no evidence of trade-off between being profitable and reaching the poor. Similarly, Aklilu (2002) reviews the importance of micro finance institutions in developing economies based on countries' experiences. In the review she suggested for promotion of the existing well developed institution to facilitate growth of formal MFIs.

In Ghana, the situation is not quite different if it is not the same. Since the financial sector reforms and the introduction of formal micro financing in the 1990s, a lot of improvements have been experienced in the financial sector. Before this period there was no established private bank in Ghana. The period of reform since 1990 witnessed the establishment of new banks most of which were privately owned. The reform encouraged the financial institutions to upgrade their technology especially by computerizing their operations (Acheampong and Mensah, 2006).

The introduction of the new banks with their new technologies and development brought about healthy competition in the financial sector. This was enhanced mainly by the introduction of sophisticated financial services and electronic purses and also due largely to the innovative and revolutionary practices of the new banks in the country. As stated by Aryeetey Nisanke and Steel, the new policy and legal environment stimulated a variety of both bank and non-bank financial institutions (NBF's) which substantially broadened the range of instruments and choices available.

Today, these new banks and the NBF's offer microfinance service to increase the choices of financial services available to the public. The involvement of these institutions in microfinance has increased the awareness microfinance being an effective tool in fight against poverty and hunger.

2.9.MICROFINANCE REVOLUTION

Microfinance is often dated back to the 1970s, then, any program of microfinance passes two key tests; the tests are the following;

- Show that people can be relied on to repay their loans, and

- Show that it is possible to provide financial services to the poor people through market-based enterprises without subsidy from the government and other institutions such as Non-governmental Organizations (NGOs).

Recent evidence gathered by Timothy Guinnane, an economic historian at Yale, raises questions about this view. Guinnane demonstrates that the success of Friedrich Wilhelm Raiffeisen's village bank movement in Germany, which began in 1864 and reached 2 million rural farmers by 1901, resulted in large part from its ability to pass both these tests.

Guinnane shows how the village-based bonds of associations of these early cooperatives gave them both the information and enforcement advantages needed to make loans to people who were both too poor and too remote to access bank loans. Raiffeisen was moved to action by the poverty of the recently freed serfs, and by the degree of exploitation they faced from local moneylenders.

The Caisse Populaire Movement founded by Alphonse Desjardins in Quebec, Canada also met these tests. Desjardins and his wife Dorimene must have had strong faith in these principles. From 1900, when he founded the first Caisse (which she managed) until 1906, when law governing them was passed in the Quebec assembly, they both risked their personal assets for the liabilities of the entire movement.

In the 1970s, a new wave of microfinance initiatives introduced many new innovations into the sector. In the early 1970s, several pioneering enterprises began experimenting with loaning to the poor, the underserved and those who do not have access to traditional financial institution facilities. An early pioneer of microfinance at the time was Akhtar Hameed Khan. The first fully-incorporated microfinance and community development bank was Shore Bank, founded in 1973 in Chicago,

USA. Economics professor Muhammed Yunus is often credited with disbursing the first micro-loan in Bangladesh in 1974. He later went on to establish the Grameen Bank in the Bangladesh and was awarded the 2006 Noble Prize for his efforts. From that time microfinance has been regarded as a powerful tool for reducing poverty. Most microfinance institutions operate according to the so called Grameen model (Brian D Butler, 2010).

2.10. MICROFINANCE IN GHANA

Indeed, the concept of microfinance is not new in Ghana. There has always been the tradition of people saving and/or taking small loans from individuals and groups within the context of self-help to start businesses or farming ventures.

For example, available evidence suggests that the first credit union in Africa was established in Northern Ghana in 1955 by Canadian Catholic missionaries. However, “Susu”, which is one of the microfinance schemes in Ghana, is thought to have originated from Nigeria and spread to Ghana in the early twentieth century.

Over the years, the microfinance sector has thrived and evolved into its current state, thanks to various financial sector policies and programmes undertaken by different governments since independence. Among these are:

- Provision of subsidized credits in the 1950s;
- Establishment of the Agricultural Development Bank in 1965 specifically to address the financial needs of the fisheries and agricultural sector;
- Establishment of Rural and Community Banks (RCBs), and the introduction of regulations such as commercial banks being required to

set aside 20% of total portfolio, to promote lending to agriculture and small scale industries in the 1970s and early 1980s;

- Shifting from a restrictive financial sector regime to a liberalized regime in 1986; (WP/BOG, 2007 Pg. 3)

Promulgation of PNDC Law 328 in 1991 allowed the establishment of different categories of non-bank financial institutions, including savings and loans companies, and credit unions. The policies have led to the emergence of three broad categories of microfinance institutions. These are:

- Formal suppliers such as savings and loans companies, rural and community banks, as well as some development and commercial banks;
- Semi-formal suppliers such as credit unions, financial non-governmental organizations (FNGOs), and cooperatives;
- Informal suppliers such as “susu” collectors and clubs, rotating and accumulating savings and credit associations (ASCAs), traders, moneylenders and other individuals.

In terms of the regulatory framework, rural and community banks are regulated under the Banking Act 2004 (Act 673), while the Savings and Loans Companies are currently regulated under the Non-Bank Financial Institutions (NBFI) Law 1993 (PNDCL 328)

On the other hand, the regulatory framework for credit unions is now being prepared, and this would recognize their dual nature as cooperatives and financial institutions. The rest of the players such as FNGOs and ASCAs do not have legal and regulatory frameworks.

Programmes currently addressing the sub-sector in Ghana include the Financial Sector Improvement Project, Financial Sector Strategic Plan (FINSSP), the Rural Financial Services Project (RFSP), the United Nations Development Programme (UNDP) Microfinance Project, the Social Investment Fund (SIF), the Community Based Rural Development Programme (CBRDP), Rural Enterprise Project (REP), and Agricultural Services Investment Project (ASSIP).

Currently, the following are some of the rural banks championing microfinance in the country; AgonaNyakrom, the first rural bank established in Ghana in 1776, Baduman rural bank, Adansi Rural Bank, Ahantaman Rural Bank, Akuapem Rural Bank, AtwimaKwanwoma Rural Bank, Bessfa Rural Bank, Kaaseman rural bank, Drobo community bank, wamfie rural bank, Kakum Rural Bank Elmina, Toende Rural Bank and others. Other financial institutions include Centre for Agricultural and Rural Development (CARD), Cedi Foundation, Christian Rural Aid Network (CRAN), Enowid Foundation, First Allied Savings and Loans, Kraban Support Foundation (KSF), ProCredit, Midland Savings & Loans, Sikaman Savings & Loans, Sinapi Aba Trust, and a number of church and teachers' credit unions.

2.11. THE PERFORMANCE OF MICROFINANCE INSTITUTIONS

Microfinance has attracted much attention in the recent years. Some commentators have brimmed over with enthusiasm and optimism and see microfinance as the panacea to under development. Measuring the performance of microfinance institutions (MFIs) is not a trivial task. Indeed, looking at the financial sustainability of an MFI only gives one feature of its performance. As many MFIs primarily exist in order to help the poorest people, one also has to include aspects of outreach in their performance. Hence, MFIs performance can be termed

multidimensional. The committee of Donor Agencies for small enterprises Development and Donors working Group on financial sector development has come out with principles that could be used to assess the performance of microfinance institutions.

2.12. INSTITUTIONAL STRENGTHS

This refers to institutional Culture, structure, capacities and operating systems that can support and sustained service delivery to a significant and a growing number of low income clients. In measuring the strength of the institutions, the group maintained that MFIs should have sound governing structure which encompasses freedom from political interference, competent and stable staff, a strong business plan and mission and vision which creates a sense of purpose and accountability. Also institutional strength measurement, according to the group should focus on accurate management information system that are actively used to make decisions, motivate performance and provides accountability for fund operations that manage small transactions efficiently with high productivity as measured by variables such as loans per staff is very crucial in measuring institutional strength. Operating cost as a percentage of average annual portfolio is yet another measure of the institutional strength of microfinance. There should as a matter of fact be a good reporting standards for transparent financial reporting and allows prospective funders to evaluate performance adequately. Any institution that practised the above principle is therefore considered to be performing well. (Committee of Donor Agencies for small Enterprise Development and Donors working group on financial Sector development, June 1995)

2.13. OUTREACH

Effort to extend microfinance services to the people who are underserved by financial institutions are classified as outreach. Outreach can be measured in terms of breadth-number of clients served and volume of services (i.e., total savings on deposit and total outstanding portfolio) or depth-the socioeconomic level of clients that MFIs reach.

Breadth; In 2003, the 163 reporting MFIs in Africa served almost three times as many voluntary savers (6.3 million) as borrowers (2.4million). In general, MFIs reached many more savers than borrowers. Outreach in Africa varies by region, although West Africa is home to the largest number of reporting MFIs.

The East Africa region dominates the outreach results with 52 percent of all savers and 45 percent of all borrowers in Africa. This dominance is explained by the presence of two very large borrowing institutions in Ethiopia (Amhara Credit and Savings Institution ACSI and Dedebe Credit and Savings Institution DECSI) and the largest savings institution in Kenya (Kenya Post Office Savings Bank KPOSB). MFIs reporting from West Africa include a few big players but many very small ones as well. MFIs in Southern Africa represent only 17 percent of reporting MFIs, but results for this region are heavily influenced by Teba Bank in South Africa, which manages a GLP representing 24 percent of the outstanding balance of micro loans for Africa and 83 percent for Southern Africa. Outreach numbers also vary by MFI type, In Africa; unregulated MFIs tend to be much smaller than their regulated and cooperative counterparts. Indeed, unregulated MFIs account for 22 percent of all reporting MFIs but represent only 11 percent of borrowers and, more tellingly, 4 percent of voluntary savers. The significant outreach to savings clients of regulated

and cooperative MFIs underscores the importance of savings products in Africa. Proportionally smaller than their peers, unregulated MFIs reach fewer savers because the regulations in many countries prohibit or limit the mobilization of savings by unregulated institutions.

Depth: By definition, MFIs offer financial services to low-income clients. Some MFIs achieve deeper outreach by targeting the client groups that are most vulnerable such as women and/or people with very low incomes.

In 2003, women represented 61 percent of borrowers among the reporting MFIs in Africa. By comparison, women represent an average of 86 percent of borrowers among MFIs in South Asia, 80 percent in Middle East and North Africa (MENA), 76 percent in East Asia (Anne-Lucie et al, 2006).

2.14. FINANCIAL PERFORMANCE

The most important area of performance assessment of MFIs is the financial sector. It is argued that offering loans at rates sufficient eventually to cover full cost of efficient lending on a sustainable bases should form the core of the appropriate pricing policies of the institutions. Interest charges by the institution, loan losses and a minimum return on equity.

For MFIs to be classified as financially satisfactory there is the need for that institution to be financially self-sufficient. Thus strives should be made to steadily reduce their dependence. Administrative costs and loan losses with client revenue within a reasonable period given local conditions is very critical.

MFIs earn financial revenue from loans and other financial services in the form of interest fees, penalties, and commissions. Financial revenue also includes income from other financial assets, such as investment income. An MFI's financial activities also generate various expenses, from general operating expenses and the

cost of borrowing to provisioning for the potential loss from defaulted loans. Profitable institutions earn a positive net income (i.e., operating income exceeds total expenses). For the purpose of this review and to account for the institutional scale of operations, financial revenue and expense indicators as well as returns are compared against the institution's assets. Of the 163 MFIs analyzed, 77 (47 percent) earned positive returns in 2003. Compared with other global regions, MFIs in Africa report the lowest average ROA; (2 percent). One explanation for lower profitability of MFI's in Africa than other global regions is that African MFIs earn lower average financial revenues, which do not cover the high operating expenses in the region. Throughout Africa, weak infrastructure (communications and road), low average population density combined with predominantly rural markets, and high labour costs all contribute to operating expenses. Across African regions, MFIs in East Africa are the most profitable and those in West Africa also generate positive returns, whereas MFIs in the Central Africa, Southern Africa, and Indian Ocean regions generate negative returns. The low profitability of MFIs in Southern Africa stem from the poor performance of small and large MFIs alike (Anne-Lucie et al, 2006) .

2.15. CRITICISMS OF MICROFINANCE INSTITUTIONS

The expanding coverage and range of services associated with microfinance institutions can be taken as prima facie evidence of their success including from the donor community, for them to play an even bigger role in development strategy. However microfinance programs have particularly given their frequent reliance on subsidies, also face serious criticisms over both their financial viability and comparative effectiveness in tackling poverty. Others have insisted that the main mission of microfinance is to serve the poor and worry that, since microfinance does not yet sufficiently extend its reach to the extreme poor, raising interest rates and

increasing the scale of production will only lead to further exclusion of the poor from these programs. Critics contend that microfinance does not reach the poorest of the poor, that it only affects the better-off portions of poor populations. Loan officers often discriminate between very poor borrowers and favour the 'richer' poor who can afford to take out larger loans.

Borrowing may create a heavy debt for some poor families - in countries where small business are subject to a great number of obstacles. In this circumstance, borrowing money is a risk for the poor who already experience extremely vulnerable economic shocks. Microfinance doesn't cover generations and all regions. The most biting indictment against microfinance is that it requires the poor to be entrepreneurial. But, it is clear that most people do not have entrepreneurial skills. These institutions fail to back the financial services they provide their prospective clients with the required skills that will enable them to make good use of the loans. This leads to inappropriate use of funds and hence high incidence of defaults (AzerAlesker, 2007).

The concept of microfinance has been criticized as being non-confrontational. It does very little to challenge existing economic and social inequalities or the structures that perpetuate such inequity. For instance, it does not confront the issue of unequal access to land, an important concern in rural areas in developing countries. Microfinance proponents, however counter that allegation with the argument that microfinance would lead to reduction in at least economic poverty (Swope, 2007).

CHAPTER THREE

METHODOLOGY

3.1. INTRODUCTION

This chapter gives a comprehensive depiction of the choice of the study area. It explores the population from which subjects for the research were selected and the sampling procedures used. A detailed depiction of data collection instruments, data collection procedures, the research design, data analysis and putting the indicators into context as well as showing how the various financial ratios were calculated are all encapsulated in this chapter. It is concluded with the limitations the researcher faced during the data collection period.

3.2 THE STUDY AREA

The target population consists of microfinance institutions; distinctively rural banks, savings and loans companies and credit unions in the Municipality. In all, there were eleven of these institutions operating within the vicinity of the municipality, including one rural bank.

3.3 POPULATION AND SAMPLING TECHNIQUES

By resorting to Von Neumanns method, where in a population of small numbers, 30% of the total population is taken to form the sample size and this will give a fair idea about the main characteristics of the population, a sample size of (three) 3 institutions; one credit union, one savings and loans company, and one rural bank, were selected from the total population. Both purposive and simple random techniques of sampling were employed by the researcher in selecting samples. As the very topic suggests, the research was conducted on MFI's in the

Ashaiman municipality. Therefore only MFI's, which really undertake microfinance activities and operate in the Ashaiman municipality, were selected.

Based on this criterion Dangme Rural Bank was automatically selected because it was the only rural bank in the municipality. However, by using simple random technique, Dzadikuma Credit Union and Pro Credit Savings and Loans were selected and added to the one already selected to make the number of institutions required for the study. These institutions are vibrantly in operation and it is believed that data obtained from them is the true representation of the activities of MFI's in the municipality.

3.4 DATA COLLECTION PROCEDURE

The researcher resorted to the use of both primary and secondary data. The primary data was collected using a well-structured questionnaire which was filled by the managers of the three institutions. This was enhanced by showing to the managers of the institutions an introductory letter from the institute seeking their cooperation. This actually enabled the managers to answer the questions without much probing into the importance of the study. However, since the timing for the data collection, according to the managers, coincided with the preparation of their first quarterly report preparation, it took the researcher a month to retrieve the answered questionnaire. It must also be admitted that the managers were initially reluctant to answer the questionnaire but upon further explanation of the purpose of the research to them, they were convinced and hence provided the required information.

Again, the researcher used some secondary data chiefly from publications, magazines, journals, and text books as well as financial reports of some financial institutions and from the surveyed institution.

3.5 RESEARCH INSTRUMENTS

To ensure the smooth conduct of the research, the researcher designed a set of questionnaires which were meant to be answered by the managers of the institutions under study. There were thirty-five (35) items contained in the questionnaire. These items were further grouped into three sections. The first section dealt with the background of the institutions. Performance indicators, which were also further divided into two sub sections; the absolute indicators and the financial indicators, were contained in section two. Last but not the least section of the questionnaire took charge of the strategies used by the institutions to win customers, serve customers and motivate their workers. Some of the items in the questionnaire contained in the last section were open-ended. This was done to enable the researcher gather additional useful information from the institutions which the questionnaire might not have captured. Even though there are possibilities of people giving their personal opinions and biases in answering open-ended questions, the researcher painstakingly explained that portion of the questionnaire to the managers to ensure that the open-ended question were objectively answered.

To ensure that the questions were relevant enough to answer the research objectives, the researcher obeyed some basic canons of a good question. First, all the questions were drawn from the research objectives. Second, to prevent personal influence of responses, most of the questions were close-ended. Third, follow-up question were used to ensure validity of other responses. Last, the validity of the items was determined by the researcher with support of the supervisor.

3.6 RESEARCH DESIGN

A survey design, according to Fowler (1988), is that which provides a quantitative or numerical description of some fractions of a population through collection process of asking question relevant to the research as well as the kind of research that is being undertaken.

In accordance with this, the researcher resorted to the use of time series analysis as the appropriate design for the study. Thus, for the critical assessment of the financial performance of MFIs in the Ashaiman municipality there was the urgent need for the researcher to take into consideration a time period so that the right trend can be revealed. Based on this, trend analysis was also used to assess the performance of the financial indicators.

3.7 DATA ANALYSIS

Having finished with the data collection, the researcher organized, summarized, and analysed it using financial ratios and percentages. To do this, the researcher used the internationally accepted ratios for measuring the performances of MFIs as a yardstick to compare the performances of these institutions. These ratios were put forward by the Committee for Donor Agencies and it is purposely used to measure and assess the performances of microfinance institutions globally. The researcher compared the performance of the institutions and appropriate remarks and comments were made on their strengths and weaknesses. For easy identification and comparisons, table were used to depict the indicators.

3.8 PUTTING THE INDICATORS INTO CONTEXT

Three main categories for measuring performance of MFIs were used by the researcher to assess the performance of these institutions. These are portfolio quality, financial management, and profitability.

Portfolio Quality: Portfolio refers to total funds available for the MFI to use as loans to its clients. Portfolio quality is a measure of how well or how best the institution is able to protect this portfolio against all forms of risks. The loan portfolio is by far an MFI's largest asset and, in addition, the quality of that asset and therefore, the risk it poses for the institution can be quite difficult to measure. Portfolio quality is a vital area of analysis, since it is the largest source of risk for any financial institution. Therefore, as much as possible, MFI's must try to maintain the quality of their portfolios.

3.8.1 How to calculate portfolio quality:

For MFI's to maintain the quality of their portfolios, they must use standardized measures to measure the risks associated with their portfolio. Various measures are used to measure portfolio quality in the microfinance industry. These include Portfolio at Risk (PaR), Write-Offs. Portfolio at risk, which measures the portion of the loan portfolio "contaminated" by arrears as a percentage of the total portfolio is the most widely used.

- **Portfolio at Risk (PaR)**

This shows the portion of the portfolio that is "contaminated" by arrears and therefore at risk of not being paid. It is calculated by dividing the outstanding balance of all loans with arrears over 30 days, plus all refinanced or restructured loans by the outstanding gross portfolio as of a certain date.

PaR = {Outstanding Balance on Arrears over 30 days + Total Gross Outstanding Refinanced (restructured) Portfolio}/Total Outstanding Gross Portfolio

- **Write-Offs Ratio (WOR)**

This indicator represents the loans that the institutions have removed from its books because of a substantial doubt that they will be recovered. It is an accounting transaction to prevent assets from being unrealistically over bloated by loans that may not be recovered. It thus affects the gross loan portfolio and loan loss reserves equally. It was calculated by dividing Total Write Offs for the period by the periods, Average Portfolio.

WOR = Value of Loans Written Off / Average Portfolio

3.9 FINANCIAL MANAGEMENT

This assures that, there is enough liquidity to meet the institutions obligation to disburse loans to its borrowers and to repay loans to its creditors. Errors in liquidity management can easily compromise an institution with efficient credit operations and sound management. Financial management assessment was also carried out to find out if the MFI's studied are financially sustainable or not; if not sustainable to determine their level of dependability on other donor agencies. The research therefore considered two indicators that helped in assessing the financial performance of the institutions. These are Funding Expenses, and Debt or Equity (Return on Equity).

3.10 MEASUREMENT OF INDICATORS FOR FINANCIAL MANAGEMENT

Various indicators are used to measure financial management. However, these are Cost of Fund Ratio and Debit or Equity Ratio. However, the researcher used two of these ratios; Funding Expenses Ratio and Debit or Equity Ratio to measure the financial management.

- **Debt or Equity Ratio**

This was used to measure how much cushion (in the form of equity) the MFI's had in order to absorb losses that they may incur. It was thus used to determine capital adequacy of the MFI. The Debt/Equity Ratio was calculated by dividing total liabilities of the MFI by its total equity as a percentage. Mathematically,

$$\text{Debt/Equity Ratio} = \text{Total Liabilities} \div \text{Average Total Equity}$$

$$\text{Funding Ratio} = \text{Interest+Fee Expenses} \div \text{Average Portfolio}$$

- **Profitability**

All microfinance institutions are set up to be profit oriented organizations and hence the researcher found it more prudent to measure the profitability of the MFI's. Profitability measures tend to summarize the performance in all areas of the institution. Hence, portfolio quality, Efficiency and productivity and financial management policies all tend to influence the profitability of the MFI. The researcher in attempt to measure the profitability of the MFI considered two main indicators; Return on Equity and Return on Assets.

3.10.1 How to measure indicators for profitability

Three indicators can be used to measure profitability. These are Return on Equity, Return on Asset and Portfolio Yield. For the purpose of this study, Return on Equity and Return on Asset were used by the researcher.

- **Return on Equity**

This was used to measure the return on the investments made by the institutions over the 2007 and 2010 period under consideration and hence an indicators for profitability of the institution. It was calculated by dividing net income by the periods' average equity and as overall percentage. Mathematically,

$$\text{Return on Equity (RoE)} = \text{Net Income} \div \text{Average Equity}$$

- **Return on Asset (RoA)**

This gave an overall measure of profitability of the MFI's that reflects both the profit margin and the efficiency of institution. Thus it captures how well asserts, both fixed and liquid of the institutions are used. This is obtained by dividing Net Income of the institutions by Average Assets of the institution within the period of consideration as a percentage. Mathematically,

$$\text{Return on Asset (RoA)} = \text{Net Income} / \text{Average Assets}$$

It is worth nothing that, these are not the only performance indicators used in assessing performance but the research chose only these ones for lack of time and resources.

3.11 LIMITATIONS

Admittedly, a number of limitations were encountered during the data collection process; these included unavailability of immediate secondary data which

resulted from poor records keeping, unwillingness on the part of managers of the institutions to fill the questionnaire since they perceive the research as a means to uncover their operational weaknesses, financial and time constraints. However, despite all these limitations, the research was successful after I gave them personal assurance of the anonymity and confidentiality of the results although this was specified on the questionnaire.



CHAPTER FOUR

4 ANALYSIS, DISCUSSION AND REPRESENTATION OF RESULTS

4.1 INTRODUCTION

This chapter covers the discussion, analysis and presentation of results. Discussions and comparison of the change and absolute values of the ratios, changes in absolute performance indicators and the various operational strategies were examined. The presentation of the result was by tables and percentages.

4.2 MFIs AND THEIR SERVICES

There are many MFIs in the Ashaiman Metropolis but the focus of the study was on Rural Banks, Credit Unions and Savings and Loans Companies. Three of such institutions were used for the study.

The main services rendered by the MFIs are taking of deposits and giving out credits (loans). They undertake these functions by employing various strategies as depicted in items A to J which makes up table 1 below;

Table 1: Operational Strategies of MFIs (Source: Field data 2011)

A. Marketing Strategies

STRATEGY	MFIs		
	RB	S&L	CU
• Price Penetrating	Yes	No	No
• Advertisement	Yes	No	No
• Public Education	Yes	No	Yes
• Others	Yes	Yes	No

B. Mobilization of Savings

STRATEGY	MFIs		
	RB	S&L	CU
• Mobile Bankers	Yes	No	No
• Education	Yes	No	No
• Issuance of savings booklet	Yes	Yes	Yes
• Others	Yes	Yes	No

C. Sources of extra funds

STRATEGY	MFIs		
	RB	S&L	CU
• Government	Yes	No	No
• NGOs	No	No	No
• Friends and Family members	No	No	Yes
• Other Financial institutions	Yes	Yes	No
• None	No	No	Yes
• Others	No	Yes	No

D. Services rendered

STRATEGY	MFIs		
	RB	S&L	CU
• Savings	Yes	Yes	Yes
• Loans/ Credit	Yes	Yes	Yes
• Micro transfer	Yes	Yes	No
• Micro leasing	No	No	No
• Others	Yes	No	No

E. Factors to consider when granting loans

STRATEGY	MFIs		
	RB	S&L	CU
• Industry of the business	Yes	Yes	No
• Business size	Yes	Yes	No
• Business environment	No	Yes	No
• Savings of applicant	Yes	No	Yes
• Type of applicant (first time or repeat)	Yes	No	No

F. Loan loss recovery procedures

STRATEGY	MFIs		
	RB	S&L	CU
• Police enforcement	Yes	Yes	No
• Court action	Yes	Yes	Yes
• Confiscation of leased property	No	Yes	No
• Others	Yes	No	No

G. Means of motivating staff

STRATEGY	MFIs		
	RB	S&L	CU
• Accommodation	No	No	No
• Means of transport	No	No	No
• Traveling allowances	Yes	Yes	No
• Medical health care	Yes	Yes	No
• Rest leave	Yes	Yes	No
• Study leave	Yes	No	No
• End- of- year gets together	Yes	Yes	No

H. Monitoring of clients

STRATEGY	MFIs		
	RB	S&L	CU
• Supervision	Yes	Yes	Yes
• Occasional visitations	Yes	Yes	No
• Giving business advice	Yes	Yes	No
• Others	Yes	No	No

I. Frequency of evaluating operations

FREQUENCY	MFIs		
	RB	S&L	CU
• Monthly	Yes	Yes	Yes
• Quarterly	Yes	Yes	No
• Annually	Yes	Yes	Yes
• Others	Yes	No	No

J. Clients categories (the one with the higher proportion starts with 1)

CATEGORIES	MFIs		
	RB	S&L	CU
• Farmers	3	-	2
• Petty traders	1	1	3
• Artisans(carpenters, masons, carvers etc)	4	2	4
• Teachers	2	-	1
• Drivers	5	-	5
• Others	6	-	6

K. Computerization of operations

MFIs		
RB	S&L	CU
Yes	Yes	No

NOTE: Yes means applicability of strategy
No means non- applicability

4.3. TRENDS OF ABSOLUTE PERFORMANCE INDICATORS

Table 2: Total Assetsof MFIs

MFI	Total Assets in GHS 000			
	2007	2008	2009	2010
Rural Bank	60,209	71,069 Δ 18.04	87,654 Δ 24.74	105,874 Δ 20.79
Savings &Loans	35,307	42,513 Δ 20.41	56,933 Δ 33.92	70,075 Δ 23.08
Credit Union	29,110	35,966 Δ 23.55	44,919 Δ 24.89	55,697 Δ 23.99

Source: Field data 2011

Δ Means a percentage increase over the period

∇ Means a percentage decrease over the period

From the table above, total assets of Rural Bank increased from GHS 60,209 to GHS71,069 in 2007 to 2008 period. This represents 18.04% increment. Over the same year, Savings and Loans' total assets also increased from GHS 35,307 to GHS

42,513 which also represents 20.41% increment. In the same way, Credit Union's total assets also increased from GHS 29,110 to GHS 35,966 in the same period indicating 23.55% increase.

Comparing these MFIs within the 2007-2008 year period, even though there was an increase in their total assets which shows good performance, the Credit Union had the highest increment of 3.14% more than the savings and loans and 5.51% more than the Rural Bank. Considering 2008-2009 year period, the Rural Bank again had an increase of 24.74% thus from GHS 71,069 - GHS 87,654, whilst with savings and loans there was an increment of 33.92%, from GHS 42,513 - GHS 56,933. With the credit union too, there was an increment of 24.89%, thus from GHS 35,966 in 2008 to GHS 44,919 in 2009. Though there was, again, a good performance in all the three MFIs, the Savings and Loans institution had the highest increment of 13.51% followed by the Rural Bank with 6.7% and then the Credit Union which recorded 1.34%.

Looking at the 2009-2010 year period, the Rural Bank again had an increase in its total assets from GHS 87,654 - GHS 105,874 indicating 20.79% whilst the Savings and Loans within the same period had total assets from GHS 56,933 - GHS 70,075 showing an increase of 23.08%. The Credit Union also had an increment of 23.99% in the same year thus from GHS 44,919 in 2009 to GHS 55,697.

Table 3: MFIs Total Deposits

MFI	Total Deposit GHS 000			
	2007	2008	2009	2010
Rural bank	44,438	51,091 Δ 14.97	62,503 Δ 22.34	74,510 Δ 19.21
Savings & loans	23,289	29,128 Δ 25.07	40,681 Δ 39.66	58,899 ∇ 44.78
Credit Union	20,402	26,631 Δ 30.53	34,826 Δ 30.77	45,108 Δ 29.52

Source: Field data 2011

Deposit shows how liquidity is mobilized from the community to be made available for those in need of it in the form of loans. The total deposit of Rural Bank increased from 44,438 in 2007 to 51,091 in 2008 indicating 14.97% increase. In the same way the total deposits for both the Savings and Loans and the Credit Union increased from GHS 23,289 to GHS 29,128 and from GHS 20,402 to GHS 26,631 in the same period respectively showing 25.07% and 30.53%. In view of this result it can be concluded that the Credit Union had a greater increase. This may be attributed to the fact that people are gaining much confidence in the Credit Union's deposit product and their concept of banking.

Table 4: Total Loans and Advances

MFI	Total Loans and Advances			
	2007	2008	2009	2010
Rural bank	19,500	23,900 Δ 27.69	29,700 Δ 19.28	15,400 ▽48.14
Savings & loans	23,117	26,422 Δ 14.29	32,433 Δ 22.75	48,604 Δ 49.86
Credit Union	12,568	15,246 Δ 21.31	18,255 Δ 19.74	21,990 Δ 20.46

Source: Field data 2011

MFIs basically exist to better the lot of the poor by advancing them credit hence credit must be available in meaning quantity to the poor to help them establish themselves. All the institutions recorded an increase in their loans and advances. In 2007-2008 Rural Bank had an increase of 27.69%, that is from 19,500 -23,900. Savings and Loans also had an increase from 23,117 – 26,422 representing 14.29%. On the other hand, Credit Union recorded an increase from 12,568-15,246.96, indicating 21.31% increase. Within this period, the Rural Bank performed better compared to the others. In the 2008-2009 period, the Savings and Loans recorded the highest percentage change of 22.75% followed by the Credit Union with 19.74% and the rural bank, 19.28%. This change was an increase from 19,500-29,700 for the Rural bank, 23,117-32,433 for Savings and Loans and 12,568 -18,255 for the Credit Union. For the 2009-2010 period, the Savings and Loans again recorded the highest change of 49.86%, followed by the credit union with a change of 20.45%, but the Rural bank had a decrease of 48.14%, thus from 29,700-15,400. Comparing all the

three institutions, it can be concluded that, the Savings and Loans did very well; followed by the Credit Union and the Rural Bank performed the least among them.

Table 5: MFIs breadth of outreach,

MFIs	NUMBER OF CLIENTS				
	2007	2008	2009	2010	AVERAGE
Rural bank	1568	1691	1949	2860	2017
Savings& loans	2712	2759	2690	3984	3036
Credit union	965	1001	1094	1303	1091
Average	1748	1817	1911	2716	2048

Source: Field data 2011

This shows how MFIs are reaching out, in numbers, to the poor. There was an increase in rural banks outreach from 1568 to 1691 in 2007 to 2008 period. It also increased from 1949 in 2009 to 2860 in 2010 representing an average of 2017 within the study period. In the same way savings and loans also experience a little increase in 2008 but in had a fall to 2690 in 2009 and rose again in 2010 to 3984 with an overall average of 3036. Considering the Credit Union's trend it also had an increase in its number of clients from 965 in 2007 to 1001 in 2008, 1094 in 2009 and 1303 in 2010. This indicates an average of 1091. The average number of the MFIs was 1748 in 2007, 1817 in 2008, 1911 in 2009 and 2716 in 2010 showing an overall average of 2048.

4.4. FINANCIAL RATIO INDICATORS

Table6: MFIs PaR ratio

MFIs	PaR 30 %				
	2007	2008	2009	2010	Average
Rural bank	4.40	14.50	14.72	14.50	12.03
Savings & loan	4.01	5.18	7.00	4.80	5.25
Credit union	40.77	32.94	27.86	28.17	32.44
Average	16.39	17.54	16.53	15.82	16.99

Source: Field data 2011

Since micro credit is not backed by bankable collaterals, MFIs' portfolio at risk (more than 30 days) should not be above 10%. 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% must be checked out.

The rural bank in 2007 rose in its PaR. It rose from 4.40% in 2007 to 14.50% in 2008. There was a further increase to 14.72% in 2009 but fell back to 14.50% in 2010. On the average this records represented 5.25%. That of the savings and loans was fluctuating on a small interval ranging from 4.01.0% to 5.18% of the entire period. The credit union also faced some kind of fluctuation but on a higher range. In 2007 its PaR was 40.77% but fell to 32.94% in 2008. In 2009 it further fell to 27.86% but had a slight rise to 28.17 in 2010 with an average of 32.44. Comparing the three institutions, the savings and loans performed better with an average of 5.25% indicating they can continue to be in business since they were able to retrieve most of their loans with the help of recovery team and court actions. The credit union is at a high risk of sustainability since their PaR is 32.44% which is greater than 10%. If care is not taken, they will be unable to sustain their business.

Table: 7 MFIs Loan Recovery rate

MFI	LOAN RECOVERY RATE (%)				
	2007	2008	2009	2010	Average
Rural bank	84.3	59.74	58.08	57.63	64.94
Savings & loans	95.99	94.82	93.00	95.20	94.75
Credit union	59.77	6.76	72.75	73.65	53.23
Average	60.10	53.77	74.61	75.49	70.97

Source: Field data 2011

From the analysis above, on the average the rural bank had 64.94% loan recovered over the four (4) year period from 2007 to 2010. It had 84.3% loan recovery rate in 2007 but fell in 2008 to 59.74. It further fell to 58.08% in 2009 and to 57.63% in 2010. Considering the savings and loans institutions it decreased from 95.99% in 2007 to 94.82% in 2008. It again increased to 93% in 2009 and to 95.20% in 2010. The average of loans recovered from 2007-2010 was 94.75%, showing that the savings and loans was able to recover most of their loans as compared to the rural bank and the Credit Union. The credit union also recorded 59.77% in 2007 and decreased to 6.76% in 2008. In 2009 it increased to 72.75% and to 73.65% in 2010 indicating an average of 53.23%.

Comparing the three institutions, some of the reasons that may account for the high recovery loan rate of the savings and loans may include issuance of secured loans, effective and efficient for collecting of outstanding loans and better credit worthiness assessment and also the use of credit recovery team. These factors may not be the same (or minimal) with the other institutions.

Table 8: MFIs Cost Per Borrower

MFIs	Cost Per Borrower (%)				
	2007	2008	2009	2010	Average
Rural Bank	37.95	54.28	80.84	81.31	63.6
Savings & Loans	35.32	47.30	57.19	73.69	53.38
Credit Union	28.45	34.85	43.15	38.69	36.29
Average	33.91	45.48	60.39	64.56	51.09

Source: Field data 2011

Cost per borrower shows the average cost of maintaining an active borrower.

It is calculated by dividing all expenses related to the operations in an institution (including all the administrative and salary expenses, depreciation and board fees) by the average number of active borrowers. Interest, provision expenses and extraordinary expenses are not included. The Rural Bank recorded an average of 63.6 of cost per borrower. This average was as a result of 37.95 in 2007, 54.28 in 2008, 80.84 in 2009 and 81.31 in 2010. The savings and loans had an increase from 35.32 in 2007 to 47.30 in 2008. It further increased to 57.19 in 2009 and to 73.69 in 2010 with an average of 53.38. In the same way the credit union also recorded an increase from 28.45 in 2007 to 34.85 in 2008 and in 2009 it recorded 43.15 but fell to 38.69 in 2010 having an average of 36.29.

Comparing these institutions, it is clear that the credit union had a lower amount needed to maintain an active borrower and the Rural Rank needed the highest amount of 63.6 to maintain an active borrower. High operating expenses can be sure signs of inefficiency as such, it can be said that, the Credit Union is the most efficient and the Rural Bank is the least in this regard.

Table 9: MFIs Personnel Productivity

MFIs	Personnel Productivity (%)				
	2007	2008	2009	2010	Average
Rural Bank	54	58	67	98	69
Savings & loans	43	43	42	63	48
Credit union	160	166	182	217	181
Average	85	89	97	126	99

Source: Field data 2011

Personnel productivity captures the productivity of institution's staff-the higher the ratio the more productive the institution. It is calculated by dividing the total number of staff by number of active borrowers of an institution. The Rural Bank recorded a personnel productivity ranging from 54 to 98 within the entire period with an average of 69. The Savings and Loans was from 43 in 2007 and remained same in 2008 and fell to 42 in 2009 but had an increase to 63 in 2010. This indicates 48 average of personnel productivity which is lesser than that of the Rural Bank. The Credit Union was more productive because it had a higher ratio of 181 on the average. This may be due to the kind of motivation given to its staff such as medical health care and end-of-year-gets together and the ease of processing loans.

Table 10: MFIs Debt/Equity ratios

MFIs	Debt/ Equity ratio%				
	2007	2008	2009	2010	Average
Rural Bank	50.89	54.05	61.65	77.36	60.99
Savings&Loans	0.30	0.8	2.97	4.89	2.24
Credit Union	0.79	0.61	0.45	0.77	0.65
Average	17.33	18.49	21.69	27.67	21.29

Source: Field data 2011

The Rural Bank recorded debt/equity ratio of 50.89 in 2007 but increased to 54.05 in 2008. It increased further to 61.65 in 2009 and to 77.35 in 2010 showing an average of 60.99%; Depicting that most of its operations are financed by debt instruments and, should probably be regulated. The Savings and Loans recorded a rapid increase from 0.30 in 2007 to 0.8 in 2008. It again increased sharply to 2.97 in 2009 and to 4.89 in 2010 with an average of 2.24. The sharp increment may signify that Savings and Loans are approaching its borrowing limit which in turn will force it to curtail growth. The Credit Union's debt/equity decreased throughout the study period from 0.89 to 0.61 to 0.45 to 0.77 respectively. Implying that, more equity is used to finance business than debt.

Table 11: Return on Equity

MFIs	RETURNS ON EQUITY (%)				
	2007	2008	2009	2010	Average
Rural Bank	68.18	25.13	35.97	34.10	40.85
Savings & loans	15.00	8.90	27.60	30.01	20.38
Credit Union	43.79	58.03	38.44	8.76	37.26
Average	38.78	32.97	32.23	38.65	35.67

Source: Field data 2011

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

From the analysis above the return on equity for the Rural Bank was 68.18%, 25.13% in 2007-2008 respectively. In 2009 it increased to 35.97% and in 2010 it recorded 34.10% indicating an average of 40.85%. This shows a decline return on

shareholder's equity during the period under review; confirming the inefficiency noticed in calculating the cost per borrower. With the Savings and Loans, in 2007-2008 it recorded 15% and 8.90% respectively. In 2009 and 2010 it increased to 27.60% and 30.01%. This shows an average profit of 28.89% per investors' equity, an encouragement to invest. The Credit Union also recorded 43.79% in 2007, 58.03% in 2008, 38.44% in 2009 and 8.76% in 2010 indicating an average of 37.26%. The inconsistency in making continuous good return on equity by the Credit Union is largely due to borrowings by the shareholders against their equity.

Making an inter organizational comparison of the return on equity recorded by all three organizations, the result show that the Rural Bank made the highest average of 40.85% on its return on equity.

This comparison was made based on the assumption that all three organizations use the same accounting policies and convention to arrive at the balances in their financial statements. It must however be noted that, the overall performance in the industry in terms of return on equity was 35.67%. The trend in the industry shows a fluctuating competition since there is a fall and an increase in the return on equity for the periods; a positive return of 38.78% which fell to 32.97% and again increased to 33.23% and followed with another increase of 38.65%.

Table 12: MFIs Return On Assets

MFIs	RETURNS ON ASSETS (%)				
	2007	2008	2009	2010	Average
Rural Bank	11.37	15.51	16.32	17.80	15.25
Savings & loans	44.24	15.28	47.48	48.09	38.77
Credit Union	13.21	15.98	18.59	18.93	16.68
Average	22.94	46.77	27.46	28.16	23.57

Source: Field data 2011

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.

The return on assets for the Rural Bank from the table are 11.37%, 15.51%, 16.32% and 17.80% from 2007-2010 respectively. This indicates an average of 15.25%. With the Savings and Loans, in 2007 it recorded an amount of 44.24% but in 2008 it decreased to 15.28%. It rose again in 2009 to 47.48% and 48.09% in 2010. This shows an average of 38.77%. The Credit Union's return on assets was 13.21%, 15.98%, 18.59%, and 18.93% from 2007-2010 which indicate 16.68% on the average.

Comparing all the three institutions, the Savings and Loans institution made the highest average on return on asset of 38.77%. Meaning, for each asset employed, 38.77% return is generated. The rural bank made the least average return on its assets of 15.25%, either the assets are under-utilized or miss-managed. However, the Credit Union also made a 16.68% as the average return on the assets between 2007 and 2010. This also calls for improvement.

CHAPTER FIVE

5 SUMMARY OF FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

This chapter summarizes the entire study; the findings of the study, recommendations by the researcher, limitations encountered and directions for future research.

5.1.SUMMARY OF FINDINGS

The research was to assess the financial performance of MFIs in the Ashaiman municipality of Greater Accra Region of Ghana. The following were the specific objectives of the study;

- To find out the motivation for the influx of MFIs in the municipality?
- To find out if the MFIs in the municipality are living up to expectations?
- Are the MFIs in the municipality productive?

The literature related to this topic was reviewed and the areas that were considered included; theoretical issues in financial sector reform, microfinance and relevant concepts, justification of microfinance, products and impacts of MFIs, microfinance revolution, microfinance in Ghana, performance of MFIs, and criticisms of microfinance.

Three MFIs were selected using simple random sampling and purposive sampling procedure. These were Rural Bank, Savings and Loans Company and Credit Union. A well-designed questionnaire and interviews were employed to collect data for the analyses. The data was analyzed using Microsoft Excel. Trend analyses was also used to observe the growth in the following absolute performance indicators; total loans and advances, total clients (outreach), total assets, total deposits. Also portfolio quality, efficiency and productivity, financial management

and profitability of the MFIs were assessed using ratios. The results of the analysis was discussed and presented using tables and percentages. Conclusions were drawn after thorough discussion of the results and recommendations made to help the MFIs studied and other MFIs as a whole to improve upon their performances. It is believed that the sustainability of these institutions will be attained if the recommendations are taken into consideration. This will help reduce poverty and enhance growth and development of the municipality hence achieving the main aim of the MFIs.

During the study, very interesting findings came up; they are the following;

- During the study, it was observed that cost of borrowing from the Savings and Loans is higher than the other Microfinance institutions. Even though it was proven by the research conducted that cost of borrowing from the Savings and Loans is high as compared to all the other Microfinance institutions studied, most clients preferred borrowing from the Savings and Loans. This could be attributed to factors such as the use of modern technology, the loan processing speed, and quality customer service delivery.
- It was also observed that Credit Union which lends to only its members tend to have low recovery rate and yet members expect higher returns at the end of every financial year.

5.2. CONCLUSION

The research was successfully conducted and its objectives were achieved. Below are findings and recommended policies.

MFIs that were found to be operating in the Ashaiman Municipality provided financial services such as micro-credit and micro-savings. Just a small number provided micro-transfer and micro-leasing.

The three institutions studied recorded increment in their absolute indicators. The increments ranged between 14.07% and 67.53%. However, some of the institutions recorded reductions in these indicators during the period under study. Based on the PaR, provision expense ratio and recovery rate of the MFIs, it can be concluded that the performance was good. Data on write-off was not obtained so write-off ratios were not computed.

The efficiency and productivity which indicates how the institutions streamline their operations during the study period, it was observed that the MFIs had reasonable efficiency ratios. Credit Union performed well in terms of operating expenses and was followed by Savings and Loans. Credit union had the least cost per borrower ratio and was followed by Savings and Loans. Credit union recorded the highest personnel productivity ratio followed by Rural Bank. In terms of loan officer productivity, Rural Bank was more productive and was followed by Credit Union.

Financial management was good. On the average, the debt/equity ratios for Rural Bank, Savings and Loans and Credit Union were 60.99, 2.24, and 0.65 respectively. With the exception of Rural Bank, which recorded smaller ratios for returns on assets and returns on equity, the rest had large financial management indicators. Savings and Loans performed better followed by Credit Union.

In conclusion, aside the Rural Bank whose ratios were not appreciable in some instances, it can be concluded that the MFI's studied are performing well and they would be able to sustain in business. However, to ensure high degree of

sustainability, the MFI's are encouraged to improve upon their performances. To achieve this, below are some suggested recommendations.

5.3. RECOMMENDATIONS

Due to the findings from the study, some policy measures have been recommended to help achieve the aim of MFIs, thus poverty alleviation hence promotion of socio-economic development in the municipality. It has been recommended that:

- In order for the MFI to increase their clientele base and impact on the people, they should begin to offer other services such as microtransfer, microinsurance and microleasing in addition to the loans and savings.
- It is believed that by knowing the value of loans written-off, the MFI will strengthen their loan recovery procedures therefore the MFIs should keep records on their writ-offs every year.
- There is the need for the MFIs to upgrade the skills of their staff, employ more competent and qualified personnel to manage the institutions. This will help improve their personnel productivity.
- Credit unions should target lower income earners such as petty traders to enable them expand their customer base hence increasing their depth of outreach.
- Looking at the portfolio risk of the institutions studied, there is the need for MFIs to back their loans with some collateral accessible to the poor clients.
- The MFIs can become financially self-sufficient if they are able to reach out to large number of client hence covering their operating cost and cutting down their funding.

- To prevent loan loss or reduce loan default rates, MFIs are advised to keep records of borrowers such as their names, place of residence, workplaces, business size, the business environment, the savings of the applicant and the type of applicant (whether a first time or a repeated applicant) before granting loans.
- The MFIs should strengthen and diversify their loan recovery procedures to ensure low default rates.
- Since regulated MFIs often have more access to external funding, all MFIs in the Municipality should endeavour to computerize their operations and register to enable Ghana Microfinance Institutions' Network (GHAMFIN) to effectively coordinate their activities. This will make the MFIs more vibrant and attractive to clients.

5.4. DIRECTIONS FOR FUTURE RESEARCH

To overcome these limitations in subsequent studies, the following directions have been suggested for future research on this and other related topics;

- There must be common accounting standards for all MFIs which will give a level ground for comparison.
- The sample size should be increased so that the findings could reflect the true performance of all MFI's in the country.
- Attention must be given to impact assessment since it is also an important aspect.
- Further studies should cover the whole region, if the whole country cannot be covered.

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KNUST



APPENDIX

KNUST INSTITUTE OF DISTANT LEARNING

COMMONWEALTH EXECUTIVE MASTERS OF BUSINESS

ADMINISTRATION (CEMBA)

QUESTIONNAIRE

This questionnaire is designed for academic purpose only as part of a dissertation to be presented to the KNUST Institute of Distant Learning Commonwealth Executive Masters Of Business Administration (CEMBA). The research topic is “PERFORMANCE ASSESSMENT OF MICROFINANCE INSTITUTIONS (MFIs) IN THE ASHAIMAN MUNICIPALITY”.

I assure you that any information given shall be treated with utmost confidentiality and anonymity.

INSTRUCTIONS:

Kindly tick/select responses you deem appropriate and provide short and concise answers where necessary.

I appreciate your co-operation.

A BACKGROUND OF INSTITUTION

- 1 Name of institution.....
1. Year of establishment.....
2. Where is the headquarters located?
- 3a. Do you have other branches? Yes [] No []
- 3b. If yes, how many in all?
4. What is your staff strength? (Number of staff).....
5. Staff quality

EDUCATIONAL QUALIFICATION	NUMBER
NONE	
BECE	
SSCE	
DIPLOMA	
DEGREE	
OTHERS:	
TOTAL	

B PERFORMANCE INDICATORS

a. Absolute Indicators

INDICATORS	YEAR			
	2007	2008	2009	2010
6. Total Assets				
7. Total Deposits				
8. Total Loans & Advances				
9. Loan Recovered				

b. Financial Indicators

VARIABLES	YEARS			
	2007	2008	2009	2010
10. Total Outstanding Gross Portfolio				
11. Portfolio at Risk (more than 30 days)				
12. Total Restructured Portfolio				
13. Interest Income				
14. Fee Income				
15. Number of active borrowers				
16. Number Of Loan Officers				
17. Loan Loss Provision				
18. Refinanced Loans				
19. Value Of Loans Written Off				
20. Operating Expenses				
21. Total Equity				
22. Total Liabilities				
23. Total Funding Liabilities				

C. OPERATION STRATEGIES

24. What marketing strategies do you use?

i. Price Penetration [] ii. Advertisement [] iii. Public Education []

iv. Others (specify).....

25. How do you mobilize your savings? Through

i. Mobile Bankers [] ii. Education [] iii. Issuance of savings booklets []

iv. Other means of mobilizing savings.

(specify).....

26. From which of the following do you source extra fund?
- i. Government [] ii. NGOs [] iii. Friends and family members []
- iv. Other financial institutions [] v. Others (specify).....
27. Which of the following services do you render? i. Savings []
- ii. Loans/Credit [] iii. Microtransfer [] v. Microleasing []
- vi. Others (specify).....
28. What factors do you consider when granting loans?
- i. Industry of the business [] ii. Business size [] iii. Business environment []
- iv. Savings of applicants [] v. Type of applicant (first time or repeat) []
- vi. Others (specify).....
29. What loan loss recovery procedures do you use? i. Police enforcement []
- ii. Court action [] iii. Confiscation of leased property []
- iv. Others (specify).....
30. Which of the following are applicable as motivation for your staff?
- i. Accommodation [] ii. Means of transport [] iii. Traveling allowances []
- iv. Medical health care [] v. Rest leave [] vi. Study leave []
- vii. End-of-year gets together [] vii. Others (specify).....
-
31. How do you monitor your clients? By i. Supervision [] ii. Occasional Visitation []
- iii. Giving business advice []
- iv. Others (specify).....
32. How frequently do you evaluate your operations? i. Monthly [] ii. Quarterly []
- iii. Annually [] iv. Others (specify).....
33. Are your operations computerized? Yes [] No []

34. Please rank the following categories of people in order of higher proportion of your clients (the one with the highest proportion starts with 1)

CLIENT GROUP	RANK
Farmers	
Petty traders	
Artisans (carpenters, mansion, carvesetc)	
Teachers	
Drivers	
Others	

