REGULATIONS OF MICROFINANCE INSTITUTIONS IN GHANA

A CASE STUDY OF

FIRST ALLIED SAVINGS AND LOANS LIMITED

BY

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DECLARATION

I hereby declare that this submission is my own work towards the EMBA and that, to the best of my knowledge it contains no materials 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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DEDICATION

I dedicate this work to my son-Prince Ansah-Abrokwah. It is through his unflinching support, guidance and sense of discipline instilled in me that has brought me this far

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ABSTRACT

Responding to the rapid growth of various types of microfinance institutions (MFIs) around the world and the gap in knowledge on whether and how these institutions should be regulated, a research work is being conducted to provide a framework for addressing regulatory issues which impact the operations and the institutional development of MFIs. Kumasi which was selected for this assessment has a wide range of informal, semi-formal and formal MFIs providing financial services to the poor. Subsequent in depth – work on issues in developing sustainable rural / microfinance in Kumasi presented an opportunity to deepen the assessment of how the legal and regulatory environment is important to sustainable microfinance. This study shows the Framework Regulating Microfinance Institutions with emphasis on First Allied Savings and Loans in Kumasi. The Regulations of MFI's which was discussed included Minimum Capital Requirement, Provisioning, Collateral, Capital Adequacy, Operations, Ownership and Corporate Governance, Enforcement among others. This Research is to ascertain whether FASLC has been able to work within the Framework Regulating MFI's in Ghana and also whether the Supervision Department has played their role in ensuring effective supervision of MFI's especially First Allied Savings and Loans Company.

CHAPTER ONE

GENERAL INTRODUCTION

1.0 Introduction

The international microfinance community is showing increasing interest in the issue of regulating and supervising microfinance institutions (MFIs). By far the majority of MFIs are still not subject to government regulation. Little practical experience has been gained, and theoretical discussion is still at an early stage.

The issue is, however, rapidly attracting attention as many MFI's cannot meet their growing funding needs. On the one hand, regulation could afford them access to refinance by wholesale financial institutions and on the other it is frequently a prerequisite for taking up savings business (Krahnen / Schmidt 1994). The term regulation is very complex and is defined by (Chavez and Gonzalez-Vega.)

Regulation refers to a set of enforceable rules that restrict or direct the actions of market participants, altering, as a result, the outcomes of those actions.

It is not confined to government regulation; it also denotes the self-regulation of groups of institutions via networks, associations, etc, provided that this actually induces the actors to alter their behaviour.

The aim of this study is to analyse the regulation of Microfinance Institutions with respect to consumer protection for public depositors in financial institutions.

1.1 Background of the Study

Structure of the Microfinance Sector

Ghana has a tiered range of formal, semi-formal and informal institutions providing microfinance services to the urban and rural poor and underserved sectors of the economy. Financial intermediation and credit activities are under the regulatory jurisdiction of the Bank of Ghana (BOG). The regulatory framework under the Banking Law (1989) and the Non-Bank Financial Institutions (NBFI) Law 1993 accommodate a tiered structure of licenced financial intermediaries and of financial regulation.

The formal sector institutions providing microfinance services consist of Rural Banks, Savings and Loans (S & L) companies and Credit Unions. Rural Banks are public companies owned by communities (with capitalization assistance from the BOG), registered and licensed as unit banks (no branching privileges) under the provisions of the Banking Law. The operations of Rural Banks are Limited to a clearly- defined geographical (rural) area, and are permitted to offer banking services limited to loans and to checking savings and time deposits. Moreover, the ownership and voting control structures of Rural Banks resemble Credit Unions because of their one share- one vote structure.

Legal and Regulatory Framework for Microfinance

Except for susu collectors, susu clubs, ROSCAS and ASCAS, MFI's in Ghana are required to establish legal entry. Bank and NBFIs (which include rural banks and S & L Companies) are required to be incorporated entities under the companies Act – Credit unions have legal status and identity though registration under the Cooperative Societies Act as well as the requirements of the NBFI Law. NGO's, including those with microcredit orientation, have legal status through establishment under the provisions of the Law on Trusts and Charitable Institutions and the required registration with the Ministry of Employment and Social Welfare.

As the experience of other countries (eg. Romania) has demonstrated, reforming the legal and regulatory frameworks for financial transaction secured with movable assets has a substantial favourable impact on expanding access to markets for rural credit and microfinance. This paper seeks to address the Regulatory Framework of MFI's and whether the Regulations covers all MFI's with the view to ensuring that MFI's operate in a sound financial environment.

1.2 Problem Statement

The traditional Banks behaviour towards small-business customers is to shun them. They are of the view that dealing with small business customers is of high risk and very expensive. They believe that small business customers do not have the necessary collateral to back their loans and also applicants from the informal sector tend to apply for small loans which require some administrative processing and oversight which is to their disadvantage. Microfinance institution are expected to fill this gap by promoting higher investment leading to economic empowerment, which in turn promotes confidence and self esteem, particularly for the vulnerable. In other words, micro-finance creates access to productive capital for the poor, which together with human (addressed through education and training) and social capital (achieved through local organization building), enables people to move out of poverty. Surprisingly most of these microfinance institution make funds available to the need at high interest rate.

There are existence of abuses at different levels and misappropriation of funds by individuals who manage those funds.

Another area of concern is the level of information that is available to the beneficiary. Small firms are sometimes not aware of the existence of some financial assistance available to them. This has led to the informal sector been deprived of access to capital to help their activities.

To ensure the survival of micro finance institution in the country, there is the need to analyse the regulatory framework of these institutions to ensure that only the best out of the lot are in existence, hence to verify whether First Allied Savings and Loans Limited in Kumasi meet the regulatory requirements and qualify to serve the need of the poor.

1.3 Objectives of the study

This study is to gather empirical evidence of the regulatory framework for microfinance institution (First Allied Savings and Loans Limited) in this case. Specifically the project seeks to achieve the following objectives.

1. To identify the regulations for microfinance institutions in Ghana
2. To identify the primary methods by which observance and compliance are carried out.
3. To find out the extent to which FASLC has complied with the regulations.
4. To make appropriate recommendations to ensure that rules and regulations for microfinance institutions help them to survive and protect the interest of consumers.

1.4 Justification of the Study

Formal credit and savings for the poor are not recent inventions; for decades, some customers neglected by commercial banks have been served by credit cooperatives and development finance institutions. These organizations have legal charters that govern their financial operations and allow them access to savings or other public funding. But the past two decades have seen the emergence of powerful new methodologies for delivering microfinance services, especially microcredit. Must of this innovation has been pioneered by non-governmental organizations (NGOs), who typically do not have a legal charter authorizing them to engage in financial intermediation. Governments, donors and practitioners are now talking about new legal structures for microfinance in dozens of countries. Microfinance regulation and supervision has suddenly become a hot topic, with conferences, publications, committees, and projects appearing everywhere. Regulation of microfinance is being discussed in one country after another. But the people doing the discussion are often motivated by differing objectives, which tends to confuse the dialogue. The study is being done to draw the attention of policy makers to ensure that the Regulations of MFI's take care of the emergence of institutions that want to help the poor and the strategy to adopt to ensure its survival. Practitioners will also benefit from this research because with respect to Minimum Capital Requirement, they should work hard to get funds to meet the demands of Bank of Ghana, because where they fail, they may not be allowed to set up any MFI's. Those in the academia may also benefit from this Research Work because it will give them an overview of the Regulatory Framework of Ghana and its impact on the survival of MFI's.

1.5 Methodology of the Study

Scope of the Study

The research covers the practical operations of First Allied Savings and Loans Limited in Kumasi for a five (5) year period.

This period is from 2003 to 2007, both years inclusive. The study was in the form of case study of FASLC. The researcher's choice of First Allied Savings and Loans Limited was based on the fact that within few years of operations, FASLC has made some remarkable achievements in the area of microfinancing, through the increase in their profit before tax for 2003 to 2007. Their activities have changed the lives of many Ghanaians.

Source of Data:

Questionnaire was administered to management of FASLC and the supervisory department of Bank of Ghana

Data Analysis:

Data was analysed with the aid of tables and figures

1.6 Limitations of the Study

The following limitations may hinder the full achievement of the study objectives

1. Because of the dynamics of the study area (Kumasi), which may differ from a number of areas, the result might be difficult to replicate in all areas.
2. Since only one organization was selected for the study, the result might not be representative enough.
3. Time, financial and material resources constraints were also major barriers.

However, considering the effort and depth of the study, the problems above are immaterial. The method used in the study alone should make it possible for other independent researchers to arrive at a comparable outcome and for other microfinance institutions including policy makers to rely on.

1.7 Organisation of the Study

The project is organized as follows: chapter one focuses on general introduction and defines some key terms; chapter two reviews both theoretical and empirical literature; chapter three discusses methodology and highlights the profile of the institution under study; whilst chapter four discusses empirical results and analysis; chapter five, the last but not the least concludes and offers recommendations emanating from the findings or outcome of the study.

CHAPTER 2

LITERATURE REVIEW

2.0 Introduction

It is now widely accepted that financial sustainability is a necessary long term goal for microfinance institution. According to the Consultative Group to Assist the Poorest (1995), "Microfinance institutions can and indeed need to be self sustaining if they are to achieve their outreach potential providing rapid growth in access to financial services by poor people." Sustainability is now considered a necessary precondition for achieving growth, and therefore greater outreach to the poor. Sustainability is also desirable because it allows MFIs to access the formal sector as a source of capital, rather than relying on subsidies to bring about growth. Access to commercial capital includes the ability to source capital more rapidly and increase leverage.

This allows MFIs to expand their operations and increase the level of outreach (see Drake & Rhyne 2002). Brau and Woller (2004) conducted an extensive review on the microfinance literature. In the section on sustainability of MFIs they sited many articles concluding that institutional sustainability is a necessary goals as subsidized loan funds generally are more fragle and less focused. Factors affecting the sustainability of an MFI can broadly be divided between institutional variables and environmental variables. Institutional variable are those factors that are specific to the institution, while environmental variables relate to the policy and economic setting of the country the institution operates in. The business and regulatory environment is now considered an important factor in the success of microfinance institutions. Armendariz and Morduch (2004) conclude that MFI's cannot provide effective financial intermediation without a "well-functioning regulatory framework" in the country.

Woller and Woodworth (2001) cited many impact studies and concluded that governments must " create a microeconomic environment characterized by stable growth, low inflation, and fiscal discipline", through effective regulation.

2.1 Microfinance History

The concept of microfinance is not new. Saving and Credit groups that have operated for centuries include "Susus" of Ghana "Chit Funds" in India, "tandas" in Mexico, "arisan in Indonesia, "cheehi in Sri Lanka, "tontines" in West Africa, and "pasanaku" in Bolivia, as well as numerous savings clubs and burial societies found all over the world. Formal credit and savings institutions for the poor have also been around for decades, providing customers who were traditionally neglected by commercial banks a way to obtain financial services through cooperatives and development finance institutions.

One of the earlier and longer-lived micro credit organization providing small loans to rural poor with no collateral was the Irish loan fund System, initiated in the early 1700 by the author and nationalist Jonathan Swift. Swift idea began slowly but by the 1840 had become a wide spread institution of about 300 funds all over Ireland. Their principal purpose was making small loans with interest for short periods. At their peak they were making loans to 20% of all Irish households annually. In the 1800, various types of larger and more formal savings and credit institutions began to emerge in Europe, organized primarily among the rural and urban poor. These institutions were known as People's

Banks, Credit Unions, and Savings and Credit co-operatives. The concept of Credit Union was developed by Friedrich Wilhelm Raiffeisen and his supporters. Their altruistic action was motivated by concern to assist the rural population to break out of their dependence on money lenders and to improve their welfare. From 1870, the unions expanded rapidly over a large sector of the Rhine Province and other regions of the German States. The cooperative movement quickly spread to other countries in Europe and North America, and eventually supported by the cooperative movement in developed countries and donors, also to developing countries. The argument is that microfinance has helped individuals to have access to small loans and helping in their small scale businesses.

2.2 Evolution of Microfinance Institutions

In most Western or developed countries, it is relatively easy to obtain credit through large banks or money lending institutions. But in the developing world, where many people lack steady employment, credit history or collateral is often needed for legitimate small businesses to receive a loan.

In many ways, microfinance changed all of this. Generally defined as small lending to the rural poor in developing countries, microfinance has made great strides in the latter half of the 20th Century. The 2006 Nobel Prize awarded to Dr. Muhammed Yunus, one of the founders of modern microfinance, has helped to push the industry even further into the spotlight. But the idea of microfinance has existed for hundreds of years in many regions and in many forms.

Micro lending often starts in small villages, where family members and friends get together in money – sharing groups. Mary Coyle director of the International Institute at St. Francis Xavier University in Nova Scotia, Canada says that these savings clubs can be traced to all parts of the world. "They have operated for centuries probably since the introduction of currency" The concept of microloans took a big leap in the 1960 and 1970, when groups such as ACCION International, in Venezuela and Yunus's Grameen Bank, in Bangladesh began to institutionalize the process. By formalizing and expanding the basic concept of sharing programs, these microfinance institutions helped to build capital for small businesses rather than just loaning for basic necessities such as food, water and clothing.

Yunus first came across the idea of microcredit while studying the lives of poor entrepreneurs in his native Bangladesh during the famine in 1974. He began by loaning to groups of women, and his program soon proved that small loans could not only quickly improve lives but were paid back with interest and on time.

Existing research places the evolution of MFI funding sources within the context of an institutional life cycle theory of MFI development (de Sousa – Shields, 2004). According to this framework of analysis most MFI's start out as NGOs with a social vision, funding operations with grants and concessional loans from donors and international financial institutions that effectively serve as the primary source or risk capital for the miro finance sector. Thus the literature on microfinance devotes considerable attention to this process of "NGO transformation" as a life cycle model outlining the evolution of a microfinance institution (Helms 2006)

Microfinance institutions therefore have provided micro loans to poor people in an efficient and sustainable way. Micro lending and other financial services to poverty stricken people has been one of the effective ways of helping poor people build income and assets, manage risk, and work their way out of poverty.

2.3 How Microfinance Works

The Grameen Bank of Bangladesh has developed a joint liability model that its MFIs are using suited for local conditions.

When choosing a village the MFI conduct a comprehensive survey to brief the potential for operations and the local conditions in a village. The MFI's evaluates some key factors like village population, degree of poverty, road accessibility, political stability and safety. When a village has been selected, the MFI introduces its mission, methodology, and the services they are offering. After the informational presentation, interest women are gathered in group formations. They have to be in the age between 18 and 59. The women put themselves together in groups of five to serve as guarantors for each other. Earlier experience has shown that a group of five persons is small enough to create group pressure between the members, enforcing them to be loyal to each other. In case someone of the group members are not able to repay the loan, the group is big enough to help with the payments. The company does not influence the selection of group members nor the decision regarding the income generation activity nor the loan amount they intend to take. Group members must live close to each other and cannot be related to each other. If a borrower defaults on her loan, the entire group typically is penalized and sometimes barred altogether from taking further loans. This peer pressure encourages borrowers to be very selective about their peer group members and to repay loans in full on time. Then the group training begins, usually as a five day programme. The purpose is to educate the members in the procedures of the financial products, delivery methods, calculation of interest rates, business development skills and how to sign their names. The members are also taught in quality management to identify an income generation activity, how to set prices and how to market.

The field staff also build a culture of credit discipline and collective responsibility. The field staff makes sure the members qualifies for the programme and collect data for future analysis. Within the village, a centre is created collecting the groups. The centre is responsible for the payments of all groups, enabling a dual liability system. When the village centre is created, the financial transactions can begin. The groups meet weekly in the village centre where they can discuss new loan applications, loan utilization and community issues.

The field staff of the MFIs conduct the meetings with rigid discipline in order to sustain the credit discipline of the group. All financial transactions are conducted during the meetings.

2.4 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 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 1950's
- 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 1970s and an early 1980s
- Shifting from a restrictive financial sector regime to a liberalized regime in 1986;
- Promulgation of PNDC Law 328 of 1991 to allow 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 supplies 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 (FNGO's), and cooperatives

- Informal suppliers such as susu collectors and clubs, rotating and accumulating savings and credit associations (ROSCAs and ASCAs), traders, money lenders 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 (PNDC 328) (2).

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 player and FNGOs, ROSCAS 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 Rural Development Programme (CBRDP), Rural Enterprise Project (REP), and Agricultural Services Investment Project (ASJIP). It is also to be understood that microfinance's role in educational development is not to replace public spending but to supplement it.

Already a form of partnership exists between the government of Ghana and local microfinance communities in Northern Region of Ghana where school for life programme assist in providing cash for volunteer teachers, foodstuffs and pay for labour services to the various schools.

In Ghana today, the practice of microfinance as a vital lifeline to business particularly among the rural folk is inducing the creation of rural entrepreneurship fund which caters for unemployed people and very poor families to send their children to school and also some of the fund is channeled to the provision of other educational needs of the various communities including school blocks, library and toilet facilities.

Microfinance regulation is no longer a new field. Much has been written about it and even more has been done in terms of actually implementing these new ideas. In Ghana as in many countries throughout the world, legal framework for microfinance have been amended or, in some cases, completely revised. In the current environment, it is becoming difficult to stay abreast of new initiatives to regulate microfinance institutions.

According to Hennie Van Greuning, Joselito Gallardo, and Bikki Randhawa, (1999), the experience of Ghana shows that a transparent, inclusive regulatory framework is indispensable for enabling microfinance institutions to maintain market specialization and to pursue institutional development that leads to sustainability. Clear pathways for institutional transformation facilitate the integration of microfinance institutions into the formal financial system.

2.4.1 Rules and Roles

In Ghana, the division of power between the executive and the central bank is different for banks and for Non Bank Financial Institutions. The issuance of non banking regulation is made by the Provisional National Defence Council Secretary. (Minister of Finance) as stated in the Law. The Minister must consult the Central Bank before the issuance is made, whilst at the same time, supervisory authority remains with the Central Bank. According to a Bill for on ARB Apex Bank Law, on site inspection of rural banks are delegated to the recently established ARB (Association of Rural Banks) Apex Bank. In Ghana there has been a sharp increase in the minimum capital of non bank financial institution due to the continuous devaluation of the cedi against the major currencies. The minimum capital requirement for NBFIs was increased in 1998, 2000 and 2001.

In 2002 the minimum capital rose from 1 to 15 billion cedis (GH¢100,000 to GH¢1,500,000) and on Tuesday 23rd October 2007 Bank of Ghana proposed an increase in the minimum capital of NBFIs to 80 billion cedis (GH¢8,000,000). Interestingly, both the Ghanaian Bank Law and NBFIs Law define minimum capital in local currency in the Law, but then allow the central bank to adjust the figure after consultation with the Minister of Finance.

A consensus has emerged among experts in the field that all MFIs mobilizing deposits from the public should be regulated. An equally strong consensus says that credit – only MFIs should not be subjected to prudential regulation – defined as a regulatory system where the financial authority assumes responsibility for the soundness of financial institutions

2.4.2 Permissible and Prohibited Business Activity

The Rural Banks, Credit Unions and Savings and Loans are not directly included in the central cheque clearing and payment system. This is part of the trade-off that allows the entry of specialized financial institutions with lower minimum capital than commercial banks, and is intended to mitigate the risks of relatively weak internal controls. Bank of Ghana cancelled cheque – clearing services for Rural Banks in 1992, and did not allow for participation by NBFI's.

The demand for cheque – clearing services is one of the key motivations for Rural Community Banks to establish and join the new ARB Apex bank, which is a member of the Clearing House and hence can service its members. At least one savings and loan. issues cheque that can be cashed only at its branches. Bank of Ghana considers that savings and loans are licensed to operate as savings institutions and not as general deposit institutions, and it is not in favour of them issuing their own cheques.

2.4.3 Restricting Product Characteristics

Almost all legal frameworks for microfinance restrict certain characteristics of products in one or the other way, thus separating the microfinance tier from other tiers. Most common are limitations on the **type of deposit facilities** that may be offered. NBFIs in Ghana other than savings institutions and credit unions are only allowed to take term deposits.

In Ghana cooperative institutions take deposits from members only. Ghana NBFIs, except for the savings institutions, are subject to a lower (6 months) and upper limite (24 months) regarding the duration of term deposits. While a minimum duration might be desirable to enable a steadier – funding source, setting maximum durations can limit interest rate risk, which increase with duration (assuming that deposit interest rates are fixed) Furthermore, the size of term deposits must be at least USD 120. Presumably, this provision also aims at assuring a good funding base. For lending business, some countries stipulate a **maximum loan size**, expressed as a percentage rate of capital or as an absolute amount. In Ghana, rural banks can lend up to a limit of 25% and 10% of capital in the case of secured and unsecured loans respectively. The main rationale for limiting loan sizes is to contain risk concentration. A few large loans that turn bad can pose a great risk to the soundness of an MFI. Yet an important side effect of these limit is that they make it very unattractive for larger banks to apply for a license under this window.

2.4.4 Capital Adequacy Requirements.

Prior to the promulgation of the Banking law (1989) banks were to maintain a minimum Capital of 5% of total mobilized resources. Thus, the adequacy of capital was in a direct relationship with deposits. Following international best practice, the Banking Law (1989) shifted the adequacy of capital to its relationship to the risk assets (Asiedu Mante 1998).

The banking Law prescribes the capital base at 6% of the adjusted asset base as the minimum capital adequacy ratio for the banks; this will be raised to 10% under the new Banking Law (indraft). The NBFI Law already prescribes the rate of 10% for savings and loans and other deposit taking institutions. Likewise, credit unions are to maintain 10% of their total assets as capital (including shares)

In Ghana, banking Law uses only two weights – assets that are not included in the computation of capital requirements and those that have to the fully backed by the prescribed ratio of 6% capital. Ghana's NBFI Law use a fourth weight of 50% for loans secured by mortgage.

2.4.5 Asset Quality

The loan portfolio is an MFI's most important asset. Portfolio quality reflects the risk of loan delinquency and determines future revenues and an institution's ability to increase outreach and serve existing clients. For this paper, portfolio quality is measured as portfolio at risk over 30 days (PAR > 30 days) When MFIs are faced with poor portfolio quality, they may write off the loans from their books or refinance the loans by extending the term, changing the payment schedule, or both. Given that information about loan write –offs and the use of refinancing and rescheduling is limited, detailed analysis of portfolio quality is difficult.

All licensed financial institutions are required to monitor and review their portfolio of credit and other risk assets at least once every quarter on a regular basis. For Non Bank Financial Institutions, assets are classified into four grades of risk; (i) Current (ii) sub-standard (iii) doubtful; and (iv) loss. Assets in risk grades (ii) to (iv) are considered non-performing and therefore, no income may be accrued on them.

Bank of Ghana has specified prudential norms for microfinance and small business loans that take into account the characteristics of these activities. Micro and Small enterprise loans are required to be reviewed once monthly and are to be classified into (i) Current (ii) delinquent. A delinquent loan is one on which payment of interest or scheduled payment of principal has not been received as of due date. Bank of Ghana does not permit interest income to be accrued on delinquent loans accounts (Gallardo 2000).

2.4.6 Risk Concentration

As the number of microfinance institutions (MFIs) that rely on commercial sources of funding grows, the issue of foreign exchange (FX) risk is becoming a more prevalent concern for both investors and microfinance institutions. The risk to investments posed by currency fluctuations had led many microfinance investment vehicles (MIVs) to lend predominately in dollars or euros. While this practice of lending in hard currency protects investors, it shifts the foreign – exchange (FX) risk to microfinance institutions, which employ the hard currency debt to fund portfolios of micro loans denominated in local currency. This currency mismatch between the microfinance loans and the capital that funds microfinance institutions creates risk to the microfinance institution; if the local currency of the country in which an MFI operates depreciates against the U.S Dollar, then the MFI will be saddled with a larger – than anticipated debt obligation. Recognizing that MFIs are poorly equipped to manage FX risk, the microfinance industry is currently seeking ways to minimize or eliminate the FX risk interest in its global business.

One proposal in particular, appears promising creating a "natural hedge" by pooling loans denominated in different emerging market currencies (Dodd and Spiegel 2005 and Fernando 2006)

In Ghana, deposit taking NBFIs may not hold more than the equivalent of 50% of their equity as fixed assets. Such a requirement does not primarily reduce the risk in a financial institution but ensures that a large share of available funds in invested earning assets such as loan portfolio.

To achieve optimal FX risk management, there is the need for a partnership between the private sector and philanthropic community to overcome a major obstacle which currently prevent the private sector from providing risk management services to the microfinance industry. By effectively leveraging the expertise and resources of one and the financial resources of the other, such collaboration across – sectors has the potential to eradicate a major source of risk to microfinance investments.

2.4.7 Insider Lending

Both the Banking Law and the NBFI Law set different limits for banks and non-banks on credit exposure to individual customers (Table 2). Banks are restricted from granting secured loans in excess of 2% of net worth to any firm in which any of the bank's directors or officials are connected as a partner or principal shareholder. For unsecured insider loans, the exposure limit is 0.67% of net worth.

Table 2.

Credit exposure limit as a percentage of net worth.

	Banks	Non Banks
Secured loans	25	15
Unsecured loans	10	10

One would think that insider lending is less of a problem in MFIs then in traditional banks, or the small loan size-especially when there is a strict ceiling on loan sizes.

In Ghana, the way of dealing with insider lending is by restricting the volume of insider loans to a certain percentage of capital. Insider lending serves as one way for owners to reduce the risk imposed by capital adequacy requirements, thereby reducing the incentive for owners to manage responsibly. Setting rules to limit insider lending is particularly tricky for client-owned entities such as credit unions, village banks, and cooperatives. Additional mechanisms to promote internal control are required.

2.4.8 Liquidity Reserve Requirement

All banks and deposit taking commercial institutions are required to maintain a proportion of deposits in the form of liquidity reserves, consisting of primary reserves in cash and balances with other banks and secondary reserves in Government and BOG bills, bonds and stocks. The reserve requirement of 10% for primary and 15% for secondary have remained uncharged for Savings and loans since 1993. As part of the Government's efforts to soak up liquidity, and also to improve the solvency of Rural Community Banks by reducing the substantial delinquent loans in their books, BOG in 1996 raised the secondary liquidity reserve requirement of RCBs from 20% to 52% (the primary liquidity reserve of 10% was not changed).

The combined reserve requirement of 62% served to restrain lending by RCBs-although in practice most RCBs have held more than the required amount in Treasury Bills and other reserve assets. While originally intended to strengthen poorly-performing institutions, the regulations did not distinguish between stronger and weaker ones, thereby penalizing the more efficient and commercial RCBs by limiting their ability to pursue profitable lending opportunities.

In 2002 BOG lowered the reserve requirements and varied them according to a classification system based on loan recovery performance, enabling those with good recovery to extend more credit and forcing relatively high liquidity on those with weaker recovery (Table 3).

Table 3.

New Reserve Requirements for Rural and Community Banks (as percentage of deposits)

Classification	**Loan Recovery Rate**		
	A.90% or more	B. 75-90%	Below 75%
Placements with ARB Apex Bank*	5	5	5
Primary Reserves	8	8	8
Secondary Reserves	20	25	30
TOTAL	33	38	43

*Intended to facilitate cheque clearing

In Ghana, both rural banks and NBFIs must use part of their net profit to build an internal reserve fund. Depending on the size of the reserve fund already created, between 12.5% and 100% of net profit of rural banks and between 15% and 50% of net profits of NBFIs are paid into their fund.

2.5 Significance of Micro Credit Facilities

Micro credit fights poverty by expanding access to credit. Some microfinance institutions (MFI's) focus on maximizing profits, and do so while lending to the poor. Others seek to maximize access for the poor subject to a budget constraints. Regardless, nearly all MFIs face tightening pressure from policy makers, donors and investors to eliminate reliance on subsidies.

Loan pricing is central to economic modeling policy and practice in credit markets. Yet existing research offers little evidence on interest rate sensitivities in MFI's target market(s), and little methodological guidance on how to derive optimal rates (Morduch 2000; Armendariz de Aghion and Morduch 2005). Instead MFIs and policymakers rely heavily on descriptive evidence and intuition. Policymakers often pressure that the poor are largely insensitive to interest rates, and then prescribe that MFI's should increase rates without fear of reducing access.

Thus the assumption of price inelastic demand for credit by micro credit clients has fueled support for strategies where MFIs attempt to wean off subsidies by increasing interest rates. Microcredit has been used successfully in less developed countries, and there has already been some action in this field in the EU, both at community and at national level. In the EU, demand for this type of finance – typically, loans averaging Euro7,700 – is overwhelmingly from people setting up small companies in the service sector – micro credit can help make a business of an individual's skills and abilities.

All indications point to high potential demand from people, who, for various reasons, are unable to obtain loans in the traditional banking sector.

2.6 Selected Cases of Microfinance Institutions and Countries

Grameen Bank of Bangladesh

This bank is a successful microcredit institution. Founded in 1976 by Professor Muhammad Yunus to deliver bank credit to poverty – stricken villagers in rural Bangladesh. However Muhammad Yunus, is making mobile phone ownership possible for the country's poorest people.

The Professor has established Grameen Phone and now has 100,000 subscribers. Professor Yunus new venture has brought about much – needed communications to poor villages across Bangladesh. The Grameen Bank of Bangladesh has stepped into India. It has already obtained regulatory permission to open a liaison office in Mumbai.

Professor Yunus aim of setting up a Grameen Bank was based on the fact that the banking industry in Bangladesh has been plagued for many years by poor credit discipline, an outdated loan recovery system, corruption, inefficiency and unionization. The Grameen Bank charged an interest rate ranging between 15% and 33%, because it was the only financial institution providing access to financial services to the poorest people in Bangladesh.

Bolvia.

Innovations in lending technologies and market saturation have made La Paz, Bolvia one of the most rapidly changing and competitive microfinance markets in the world. Two lenders standout: the pioneer Banco Sol, which first profitably expanded the loan market with group liability loans, and the later entrant Caja Los Andes, which offered individual liability loans using costlier screening. Using a simple model of credit market competition with moral hazard and adverse selection, analysis is made of how terms of loan contracts were adapted to changes in competition and how borrowers incentive to remain diligent and repay loans was affected.

India.

Due to the sheer size of the population living in poverty, India is strategically significant in the global efforts to alleviate poverty and to achieve the Millennium Development Goal of having the world's poverty by 2015.

Microfinance has been present in India in one form or another since the 1970s and is now widely accepted as an effective poverty alleviation strategy. Over the last five years, the microfinance industry has achieved significant growth in part due to the participation of commercial banks. Despite this growth, the poverty situation in India continues to be challenging. Of the two major models of microfinance in India, the SHG Bank Linkage Programme (SBLP) is by far the dominant model in terms of number of borrowers and loans outstanding.

The cumulative number of SHGS linked has grown almost tenfold in the last five years, to achieve an outreach of about 31 million families, through women's membership in about 2.2 million SHGs by March 2006. Not all SHG's are currently "linked" in the sense of having loans outstanding to the banks or federations, and only an estimated half of their members are poor.

However, this still means about 14 million poor households have been reached so far. Moreover the entire membership is saving regularly, and has access to a ready source of small emergency and consumption loans in the form of loans extended out of the group's own funds.

Bangladesh

The fact that the microfinance industry has been able to provide access to credit, currently to nearly thirteen million poor households in Bangladesh is truly remarkable. There are around twelve hundred microfinance institutions (MFI) in Bangladesh (CDF 2002) but the industry is dominated by four large MFIs (BRAC, Grammen, ASA and Proshika) that serve around 11.4 million or ninety percent of all clients. These four institutions combined have over $800 million in outstanding loans and around $380 million in savings. The differences between the number of borrowers and members reflect differences in the variety of services offered by these MFIs (Proshika and BRAC) offer a range of services to their members, while (Grameen and ASA) focus on the provision of microfinance services.

After the "big four" the next larget NGO has 0.7 million clients and there are only ten NGOs who have more than 100,000 borrowers. The bottom line is that the majority of the MFIs are small (less than five thousand borrowers) and that the bulk of the access to microcredit is supplied by the four large MFI's

South Africa

South Africa's highly skewed income distribution and economic structure has produced a large number of so-called 'unbankable' households. The commercial retail – banking sector cannot profitably serve such households, which exist within the 'informal economy' and depend significantly for cash income on state transfer payments, such as pensions, and effective transfers from employed relatives.

Microfinance institution manifest itself in the form of village banks in South Africa. Village banking is based on simplified banking system at low cost, in areas that are beyond the reach of commercial banks.

The village banking integrates the community's development planning and decision making processes. The bank makes loans to the community's traditional authority for development project (USDA 2000).

Mali

Lending to rural women groups is very popular in Mali. Charitonenko and Campion (2003) highlight the case of Mali's freedom from Hunger Project. It started working with two commercial micro-finance credit unions in Mali: Nyesigiso in 1996 and Kafo Siginew in 1997. It targets rural women through its credit with Education group – lending programme. Freedom from Hunger in Mali works with local partners to offer microcredit loans to poor women in rural areas. The loans, which can vary from as little as \$5 to as much as \$300, allow the women to become entrepreneurs who run home based businesses, such as making food products or crafts to sell.

If the loans granted are paid on time, with the necessary interest, the women are eligible to access large loans.

2.7 Effectiveness of Small Businesses in Reducing Poverty

In literature or current economic life, the concept of 'small businesses' often covers different implicit areas of focus. The lack of clarity about what is understood as a small business can affect the reliability of research findings. Not surprisingly, since there are different concept of businesses, there are also different qualities of data. Grameen Foundation uses microfinance and innovative technology to fight global poverty and bring opportunities to the world's poorest people. With tiny loans and financial services, they help the poor, mostly women, start businesses (small) and escape poverty. Grameen's network of 55 microfinance institutions (MFI) partners including Growth Guarantee partners has touched more than 34 million people in 24 countries. In addition Grameen Foundation has sustained technology initiatives (village phones) in Cameroon, Kenya, Rwanda and Uganda bringing the total country outreach to 28. The development of small forms would therefore help spread income to more people.

2.8The Case for Regulating Microfinance Institutions

The regulatory environment for non bank MFIs is crucial if they are to develop and innovate. On the one hand, if MFIs are to flourish they should be able to operate relatively freely. Lack of regulation may help to explain why the microfinance sector has developed much further in Bangladesh than in other countries. As noted by Carpenter (1997): In Bangladesh, the unique circumstances of no regulatory oversight and a large, well-funded NGO community has resulted in the ad hoc evolution of sophisticated and innovative MFIs seeking to alleviate poverty.

On the other hand, it is clear that most MFIs are not operating on a sound basis. For instance, an international survey of MFIs conducted by Sustainable Banking with the Poor (1996) found that numerous MFIs did not have accurate accounting systems. MFIs that do not meet basic operational standards are not likely to reach numbers of poor clients on a sustainable basis. The task is therefore to find cost effective ways of improving the standards of the large numbers of MFIs that are not currently operating on a sound basis, while at the same time avoiding restrictions that impair their efficiency or effectiveness and meanwhile encouraging them to be innovative. It is generally accepted that financial institutions should be subjected to prudential regulation and supervision for two main reasons: (i) to protect depositors, particularly small depositors, from loss of their savings if the financial institution becomes insolvent, and (ii) to ensure the financial system as a whole does not become unstable through loss of confidence as a result of major financial institutions becoming insolvent. Unless they are extremely large, MFIs are not likely to threaten the stability of the financial systems in which they operate. This suggests that MFIs should generally not be subjected to prudential regulation and supervision unless they accept savings. There is the fact that savings mobilization is a particularly difficult issue for central banks and other regulators. Savings facilities provide a valuable service to clients, and can be important in reducing poverty. On the other hand, mobilizing savings places an onerous responsibility on an institution to ensure that the savings of clients are not at risk. Central Banks need to decide to what extent and in what forms non bank MFIs should be permitted to mobilize savings.

There are also a number of practical issues influencing the decision as to which MFIs should be subjected to prudential regulation and supervision. Most importantly, subjecting all MFIs to prudential regulation and supervision would impose a heavy burden on Central banks and / or other supervisory agencies. In most countries in the Asia – Pacific Region, Central banks have insufficient resources to undertake their core functions, including maintenance of monetary stability and prudential regulation and supervision of the banking system, let alone regulate large numbers of MFIs.

In a number of countries in East Asia, lack of attention to prudential regulation and supervision of banking systems contributed to the financial crisis which began in 1997. As suggested, the growth of the microfinance sector in countries such as Bangladesh owes much to the absence of a regulatory framework, which has allowed some MFIs to develop cost – effective and innovative methods for reaching poor clients on a sustainable basis. Christen and Rosenberg, (2000) argue that prudential regulation and supervision should not apply to MFIs that do not mobilize "Substantial amounts of voluntary deposits" This approach does not appear to be entirely satisfactory. In Bangladesh, for example, some MFIs that were previously credit only such as ASA and BURO, Tangail, are now offering voluntary savings services and attracting significant deposits. The argument for prudential regulation and supervision of MFIs appears stronger as the volume of voluntary savings they hold becomes more substantial.

However, the problem is to determine what threshold to apply. The level at which voluntary deposits become 'substantial' will vary from country to country. It is generally accepted that institutions accepting deposits from the public should be subjected to prudential regulation and supervision. Institutions not subjected to prudential regulation and supervision should not be permitted to mobilize public deposits. This raises the issue of minimum capital and other requirements for licensed financial institutions. It also leaves open the possibility that certain categories of small financial institution should be restricted in the types of savings facilities they offer, as is done with rural banks in Indonesia.

2.9 Definition of key terms

Microfinance

A general term often considered as one of the most effective and flexible strategies in the fight against global poverty.

It is sustainable and can be implemented on the massive scale necessary to respond to the urgent needs of those living on less than $ 1 a day, the World's poorest.

Microfinance Institution (MFI)

An organization that offers financial services to the very poor borrowers.

Non Government Organisation (NGO)

Is a legally constituted organization created by private organizations or people with no participation or representation of any government. In the cases in which NGO's are funded totally or partially by governments, the NGO maintains its non-governmental status insofar as it excludes government representatives from membership in the organization.

First Allied Savings and Loans Company (FASLC)

It is a microfinance institution licensed by Bank of Ghana under PNDC Law 328 (1993) to accept deposits from the public and to provide credit services to businesses and consumers.

CHAPTER THREE

METHODOLOGY AND CASE STUDY'S PROFILE

3.0 Introduction

This chapter describes the procedure adopted in conducting the research work. It consists of the scope of study, data collection procedures and data analysis procedures.

The chapter also highlights the profile of First Allied Savings and Loans Company (FASLC) the organization for this study.

3.1 Scope of Study

The research covers the practical operations of First Allied Savings and Loans Limited in Kumasi for a five (5) year period, starting from 2003-2007

The study was in the form of case study of FASLC. The researcher's choice of First Allied Savings and Loans Limited was based on the fact that within few years of operations, FASLC has made some remarkable achievements in the area of microfinancing, through the increase in their profit before tax for 2003 to 2007.

3.2 Data Collection Procedures

To help achieve the objectives of the study, data were collected from primary and secondary sources.

3.2.1 Sources of Primary Data

Primary data were obtained through the process of administering questionnaire to the management staff of First Allied Savings and Loans as well as the supervisory staff of Bank of Ghana. This methodology helped the researcher to get first hand information about the regulation of First Allied Savings and Loans Company.

3.2.2 Sources of Secondary Data

The Secondary Data was made up of the Financial Statements of First Allied Savings and Loan for the past five years which showed a remarkable increase in profit over the period.

3.3 Data Analysis Procedure

The responses from the personal interviews and questionnaires were grouped with classifications into meaningful categories after editing to ensure accuracy and reliability. Graphs and tables were drawn, and figures were arranged which helped in clear and unambiguous analysis. Data was analysed based on meanings expressed through words and classification into meaningful categories.

3.4 General Profile of First Allied Savings and Loans Company

The official FASLC brochure provides the following profile about the company. First Allied Savings and Loans Company is a microfinance institution licensed by the Bank of Ghana under PNDC Law 328 (1993) to accept deposits from the public and to provide credit services to businesses and consumers.

The Company started operations on 25th September 1996. Through its network of branches, SMS/ Mobile banking facilities, and its effective outreach banking services, First Allied Savings and Loans Company has since its inception, been actively providing financial services to its target market.

The goal of FASLC is to provide micro-credit and facilitate business development skills and support social services to Customers, Artisans, Churches, Businessmen and Women, Enterprises etc. They also give micro credit to the **ACTIVE** poor who lack access to credit from traditional financial institutions. FASLC was established with the idea of sustainable human development of poor especially women, children and the disadvantaged in the society. FASLC slogan of "We lend a helping hand" is an empowerment tool to elevate the poor and the marginalized.

3.4.1 Vision

FASLC seeks to create an excellent institution and a leader in the provision of quality financial services to the micro and small scale enterprise sector.

3.4.2 Mission

FASLC's mission is to offer convenient access to efficient, innovative and responsive financial services to the micro and small scale entrepreneur on a sustainable basis for the mutual benefit of all stakeholders.

3.4.3 Core Values

To engage in micro-financing activities through the mobilization of savings from the retail public mainly, households and small business enterprises and the provision of credit largely to its target group (micro and small business financing) The target group oriented credits are usually linked to savings, and has been reaching out to its customers through its branches, agency and a "distance banking concept".

3.4.4 Legal Status

FASLC was incorporated as a private limited liability company on March 22nd 1995 under the Ghana Companies Code, 1993 (Act 179). FASLC was incorporated as a non-bank financial institution to operate a savings and loans business in Ghana.

FASLC was granted an operating licence by the Bank of Ghana under the Non-Bank Financial Institution Law (PNDCL 328) of 1993 on March 27th 1996 to accept deposits from the public and provide credit services to businesses and consumers and subsequently received its commencement certificate from the Registrar of Companies on June 5th 1996. FASLC commenced official business on September 25th 1996.

3.4.5 Services

FASLC offers a variety of carefully designed loan products to meet special needs of its customers.

Travel Credit:- This facility allows customers and non customers alike to buy air tickets on credit from selected travel agents. The facility is granted for a short term at a competitive interest rate.

Clearance loan:- This is a short term facility, specially designed to enable importers to clear their goods with ease. The facility is available to customers and non-customers at a very competitive rate. This facility is granted within 24 hours.

Commercial Loan:- The facility is targeted at individuals and businesses who wish to expand their businesses and may be utilized to meet cash flow needs. It is available to anybody with existing account relationship with First Allied Savings and Loans Company. They offer substantial loan sizes at a very competitive interest rate.

Salary Credit:- The facility exists for employees who receive their salaries through FASLC. This facility also enables beneficiaries to access substantial loan amounts with monthly repayments, done through deductions from their salaries. Requests from salary earners who are not customers of FASLC may be considered by the salary credit.

Consumer Credit:- This is a hire purchase scheme run with selected shops. The facility is available to both customers and non customers who desire to buy consumer durables from any of these shops. Beneficiaries of this facility are only required to make a minimum deposit, with the balance of the cost paid through flexible monthly instalment arrangements.

Community Loan:- Community lending programme is an outreach programme intended to reach out to prospective customers outside the metropolis. Groups are organized into membership ranging from 5 to 20 people. They are guided through an orientation programme for six weeks where members contribute a weekly savings equivalent to 25%

of the loan amount. Each group elects their own executives who act as intermediaries between the Bank and the Group.

Various features of the Allied Mpuntu Scheme like the joint guarantee system are relayed to the Group which then apply for a loan. Apart from the above, FASLC provides Savings Accounts, Fixed Deposit for its clients as well as operating Susu Schemes.

3.4.6 Clients

FASLC works largely with the poor in the urban areas in the Kumasi metropolis. These informal micro and small scale entrepreneurs include Artisans, Associations, Businessmen and Women, Business Travellers, Drivers, Enterprises, Farmers, Importers, Exporters, Individuals, Market Women, Mechanics, Traders and Transporters

3.4.7 How Credit is Assessed

Application for a loans is sent to the bank. Loan officers will appraise the loan and the application whether all the necessary conditions have been met. The Application goes to the Advances Committee for Approval. When the loan is approved, disbursement is made into the account of the beneficiary.

All categories of loan seekers must go through the laid down rules of First Allied Savings and Loans Company.

3.4.8 Networks

FASLC is an active member of Ghana Micro Finance Institution Network (GHAMFIN)

3.4.9 Collaborations

With support from Databank Asset Management Services Limited and Stanbic Bank, FASLC has reached out to thousands of micro and small – scale entrepreneurs with micro credit facilities amounting to over billions of cedis (GH¢100,000). This is in fulfillment of its poverty reduction initiative

3.4.10 Branches

FASLC has eleven branches in Ghana with four in Kumasi, two in Accra, two in Eastern Region and Two in Brong Ahafo Region. However one branch is at Obuasi in the Ashanti Region.

Analysis of Branches

Kumasi – Adum (Head office)
Asafo, Roman Hill and
Suame

Accra - Branches at Adabraka and
Tudu

Eastern Region - Branches at Nkawkaw and
Mpraeso

Brong Ahafo Region – Branches at Techiman and
Nkoranza

CHAPTER 4

DATA ANALYSIS AND DISCUSSION OF FINDINGS

4.0 Introduction

This Chapter, discusses the research findings based on data collected from the field through the questionnaire administered and interviews conducted on First Allied Savings and Loans Company (FASLC) and Senior Staff members of the regulatory and supervision division of Bank of Ghana.

Critical examination was made on official documents of (FASLC). Two sets of questionnaires were administered. These questionnaires were prepared for management of FASLC and some senior staff of the Regulatory and Supervision Department of Bank of Ghana. The analysis was conducted based on Minimum capital requirement, Provisioning, Capital Adequacy Requirements, Collateral, Ownership and Corporate Governance, Operations, among others.

Key Regulations for Microfinance Institutions in Ghana

4.1 Minimum Capital Requirement

Data from BOG revealed that they have set up rules in the regulation which state that all institutions which operate under the Financial Institutions (Non Banking Law, 1993, PNDC Law 328) require not less than GH¢1 Million as minimum capital for non-deposit taking business and GH¢1.5 Million for deposit taking business. Respondents from Bank of Ghana explained that any MFI's which does not satisfy the requirements of Minimum Capital cannot operate effectively as a non bank financial institutions, and cannot satisfy depositors demand. There is the need for Minimum Capital to ensure that MFI's are financially sound and can operate effectively as a bank to meet the challenges of poverty.

4.2. Provisioning

According to the respondents of the questionnaire from Bank of Ghana, the Regulations with regards to the Provisioning Requirements of Micro Finance Institutions in Ghana states that provisioning for micro and small business loans of deposit-taking Non Bank Financial Institutions is made using the following weighting 1% (General Provisions); 5% (less than 30 days); 20% (less than 60days); 40% (less than 90 days); 60% (less than 120 days); 80% (less than 150 days); 100% (greater than 150 days). For Micro Finance Institutions, provisioning is made on a 'basket basis' rather than for each individual loan. There is the need for provisioning to cater for bad debts as a result of recalcitrant customers refusing to meet their obligations of loan payment. This may help show the true profits earned by MFI's, as their profits may not be over stated as a result of taking care of the provision.

4.3. Capital Adequacy Requirements.

The Respondents from Bank of Ghana supervision department explained to the Researcher that banks require 6% paid up capital and reserves to risk- adjusted assets including off-balance sheet items. Deposit taking Non-Bank Financial Institution require minimum 10% of risk weighted assets as unimpaired own funds. The main aim of the primary reserved is to protect depositors funds.

Out of the total Deposit of Funds received in 2007 amounting to GH¢22 Million, an amount of GH¢5 Million is in the form of Cash and Short Term Funds representing 23%

of Depositors Funds, which exceed the 10% primary reserve stated in the Regulations of MFI's. This is to ensure that depositors are protected in the event of withdrawals.

4.4. Collateral

Data from Bank of Ghana indicated that MFI's should accept reasonable percentage of savings as collateral for loans to be granted. They are also to accept guarantees. They believe that reasonability can help maintain depositors confidence with the MFI's. There is the need for collateral to ensure that MFI's have made adequate provision to recover loans in case of default.

4.5 Operations of MFI's

According to the Respondents of the questionnaire from Bank of Ghana, MFI's are legally permitted to operate in certain areas. For Non Bank Financial Institutions taking deposits, they can operate Savings Accounts, Current Accounts, Fixed Deposit Accounts, and Susu Schemes, and not to engage in real estate investments. It was also revealed that MFI's should clear cheques through the Commercial Banks, and not to engage in prohibited areas of operations. There is the need for Bank of Ghana to regulate the activities of MFI's to ensure that they operate in the non-prohibited areas. This help put confidence in depositors to know the areas of MFI's operations.

4.6 Reporting Requirements

Data from Bank of Ghana explained the Reporting Requirements of MFI's. It was explained that Non Bank Financial Institutions taking deposit should send Reports to Bank of Ghana as illustrated in Table 1.

Table 1

Liquidity	Weekly
Liquidity and Exposure	Monthly
Statement of Assets and Liabilities	Monthly
Loan Analysis	Monthly
Overdraft and other Advances	Monthly
Capital Adequacy	Monthly
Maturity Analysis of Assets and Liabilities	Monthly
Deposit Rates	Monthly
Lending Reports	Monthly
Consolidated Balance Sheet	Quarterly
Other Report	Annually

4.7. Ownership and Corporate Governance

Data from Bank of Ghana indicated that Deposit taking NBFI's must have at least 5 members, two or more of whom have relevant experience. With Auditing, External Audits are required from banks and deposit taking NBFI's and must be conducted by members of the Institute of Chartered Accountants (unless otherwise approved by BOG). Banks and deposit taking NBFI's must annually submit audited accounts with an audit report to Bank of Ghana.

Table 2

Ownership and Corporate Governance	Activity
Governance	The board for FASLC have at Least 7 members, two or more of whom have relevant experience in MFI's
Auditing	External Audits required from FASLC is conducted by members of the Institute of Chartered Accountants of Ghana. FASLC submits audited accounts with an audited report to BOG.

Source: Research Department of Bank of Ghana.

4.8 Insider Lending

Respondents from Bank of Ghana gave detailed analysis of Insider Lending Activities. It stated that Banks may lend a maximum of 25% or 10% of their net worth for secured and unsecured loans respectively to single or group borrowers. For deposit NBFI's, the levels are 15% (if secured) and 10% (if unsecured). Deposit-taking NBFI's are limited to loans to connected firms of 10% or 5% of the institution's net worth (for secured and unsecured exposures, respectively).

4.9 Sanctions/Penalties

According to the Respondents of the questionnaire from Bank of Ghana, they have the authority to fine bank's and deposit taking NBFI's for Non Compliance of Regulatory Requirement. They also have the mandate to appoint their own experience banking officials to manage any distressed Financial Institutions.

Operations of First Allied Savings and Loans Company

5.1 Minimum Capital Requirements

According to the respondent of the questionnaire for FASLC, the Minimum Capital Requirement of GH¢1.5 Million has been satisfied by First Allied Savings and Loans Company and can be seen on their Financial Statement for the years 2003-2007 (see Appendix D). There is the need for Minimum Capital to ensure that FASLC is financially sound and can operate effectively and efficiently as a bank to meet depositors demand.

5.2 Provisioning

Data from FASLC, indicate that they have complied with the provisional requirements of Bank of Ghana as illustrated in Table 3 and can be seen in the Returns sent to Bank of Ghana.

Table 3

Provisioning

Days Past Due	GH¢500-GH¢2000	Loan<GH¢500 And Loan Term >1month	Loan<GH¢500 And Loan Term <1month
1-29	5%	5%	5%
30-59	20%	20%	20%
60-89	40%	40%	40%
90-119	60%	60%	50%
120-149	80%	80%	70%
150-179	100%	100%	100%
180-360	100%	100%	100%

Source: Annual Report from First Allied Savings and Loans Company

The provisioning requirement of FASLC as specified in the regulations shows that loans with the average number of highest overdue days are given the highest provisional percentage to compensate for credit risk. At FASLC, provisions are calculated for the total outstanding loan amounts of each grade of risk (Current, Sub Standard, Doubtful and Loss).

5.3 Capital Adequacy Requirement

The respondent of the questionnaire from FASLC, specified that they have been able to maintain the 10 percent primary reserve as demanded by the Regulations of MFI's. This is seen in the financial statement of FASLC (see Appendix C). Out of the total Deposit of funds received in 2007 amounting to GH¢22 Million, an amount of GH¢5 Million is in the form of Cash and Short Term Funds representing 23% of Depositors Funds, which exceed the 10% primary reserve stated in the Regulations of MFI's. (see Appendix C).

The view of Bank of Ghana shows that the ability of FASLC to meet the primary reserve is an indication of the Bank's readiness to comply with the Regulations of MFI's

5.4 Collateral

According to the Respondents of the questionnaire from FASLC, the bank has complied with the Collateral Requirements as stated in the Regulations of MFI's. This is seen in the report sent to Bank of Ghana as illustrated in (Table 4, Figure 1) below:

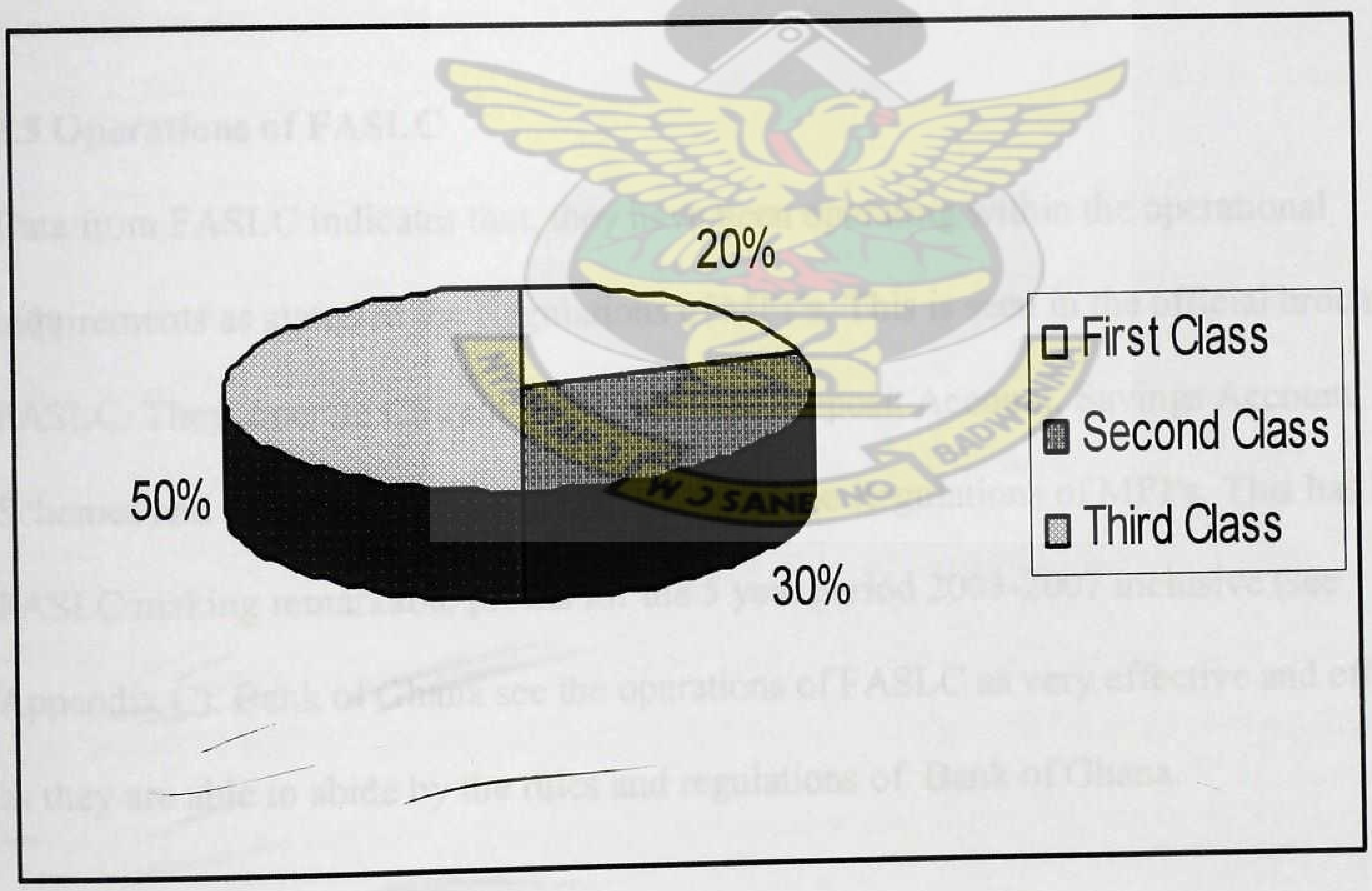
Table 4: Provision of Collateral

Category of Borrowers	Percentage of security in Relation to Loans
First Class	20%
Second Class	30%
Third Class	50%
Total	100%

Source : Calculated by Author based on personal interview.

Figure 1

A pie chart showing percentage of security in Relations to Loans



Source: Calculated by Author based on personal interview

The results from Table 4 and Figure 1 suggests that Third Class borrowers are expected to provide 50% of the loan granted as Security, Second Class borrowers providing 30% of the loan granted and First Class borrowers providing 20% of the loan granted.

FASLC are of the view that First Class borrowers have established good working relationship with them and should be given a lower percentage of their loans as security.

However, they are of the view that since Third Class borrowers have just started with them, they should provide a higher percentage of their loans as security to minimise credit risk.

Apart from Savings as a form of Collateral demanded by FASLC, the bank accepts Guarantee as a form of Collateral. This means that financially sound personalities are allowed to guarantee for a borrower.

5.5 Operations of FASLC

Data from FASLC indicates that, they have been operating within the operational requirements as stated in the Regulations of MFI's. This is seen in the official brochure of FASLC. They operate Current Account, Fixed Deposit Account, Savings Account, Susu Schemes and a whole lot of operations stated in the Regulations of MFI's. This has led to FASLC making remarkable profits for the 5 year period 2003-2007 inclusive (see Appendix C). Bank of Ghana see the operations of FASLC as very effective and efficient as they are able to abide by the rules and regulations of Bank of Ghana.

5.6 Reporting Requirements

According to the response from the administration of the questionnaire to the management of FASLC, they have strictly complied with the Requirements of Reporting as stated in the Regulations. Bank of Ghana view the reporting ability of FASLC as a way of informing the Regulatory Body of their activities and enhancing the bank's activities.

Table 5

Liquidity	Weekly
Liquidity and Exposure	Monthly
Statement of Assets and Liabilities	Monthly
Loan Analysis	Monthly
Overdraft and other Advances	Monthly
Capital Adequacy	Monthly
Maturity Analysis of Assets and Liabilities	Monthly
Deposit Rates	Monthly
Lending Reports	Monthly
Consolidated Balance Sheet	Quarterly
Other Report	Annually

This action of FASLC prompted Bank of Ghana to recommend FASLC management for implementing the rules of Reporting. This is seen in the Audit Report from Bank of Ghana in the years 2003-2007 inclusive.

5.7 Ownership and Corporate Governance

Respondents from FASLC explained in the questionnaire that FASCL have 7 board members of which all of them have experience in banking.

Table 6

Ownership and Corporate Governance	**Activity**
Governance	The board for FASLC have at Least 7 members, two or more of whom have relevant experience in MFI's
Auditing	External Audits required from FASLC is conducted by members of the Institute of Chartered Accountants of Ghana. FASLC submits audited accounts with an audited report to BOG.

Source: Research Department of Bank of Ghana.

It was found on their Financial Statement that, members of the Institute of Chartered Accountants have been auditing their accounts for the past 5 years from 2003-2007 inclusive.

5.8 Insider Lending

According to the Respondents of the questionnaire from FASLC, they have not been engaging in insider lending activities, which has helped the company to steer its affairs exceptionally. Directors of FASLC have no right to withdraw certain amounts which has not been stated in the Regulations. The Report on Insider Lending activities of FASLC was seen in the Bank of Ghana Audit Report of FASLC.

5.9 Sanctions/Penalties

Data from FASLC show that they have not contravened any of the provisions stated in the Regulations. The Audit Report of Bank of Ghana with respect to FASLC showed that Analysis. Compliance take the form of adhering to the rules and regulations of Bank of Ghana which may lead to avoidance of sanctions and penalties.

CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

5.0 Introduction

This chapter gives the summary of findings, conclusion and recommendations based on the data analysis and some key concepts in the literature.

5.1 Summary of Findings

The following findings emanated from the study

- FASLC operates within the framework of the Regulations of MFI's

  The bank operate Current Account, Savings Account, Deposit Account as well as Susu Schemes. FASLC does not engage in insider lending activities, real estate investment etc. The bank main concentration is its core business and this has helped the needy to access funds easily.

- FASLC has satisfied the minimum capital requirement by paying GH¢1.5 Million. This has helped the bank to have enough funds to meet its obligations to the public and also ensuring that only productive customers are given the necessary help. F~~ASLC has~~ complied with Regulation for the past 5 years (2003-2007) inclusive.

5.2 Conclusion

The study identified the Regulations of MFi, which FASLC operates within, with respect to Minimum Capital Requirement, Provisioning, Capital Adequacy, Collateral, Operations, Ownership and Corporate Governance.

It was revealed during the research that despite the fact that the minimum capital requirement of GH¢1.5 million has been met, FASLC are of the view that the increase of the minimum capital requirement for years to come will be a hindrance to the survival of many MFI's.

On provisioning, it was found out that many recalcitrant borrowers have the tendency of not honouring their obligation of loan payment and this calls for a stringent regulatory policy of ensuring the safety of depositors funds. Though FASLC has met the Bank of Ghana guidelines of loan provisioning, year in year out, the amount of bad debts keep on increasing.

On Capital Adequacy, FASLC has met the regulatory requirement and this is seen on their Financial Statement for 2007 and 2006.

Collateral Provision has been met by FASLC with respect to the provision of guarantees as well as a percentage of savings to qualify for loans.

Operational Activities of FALSC falls within the Regulations of MFI's. FASLC does not engage in activities not specified in the regulations and this has led to FASLC making a profit before tax of GH¢1.8 million in 2007 as against GH¢0.89 million in 2006.

With Ownership and Corporate Governance, the membership of the Board of Directors of FALSC constitutes professionals in the banking industry and this has helped steer the affairs of FASLC. Auditing of Account by External Auditors as well as the Banking Supervision Department of Bank of Ghana has also helped FASLC to operate within the Regulatory Framework of MFI's.

FASLC has proved its value, in the Kumasi metropolis, as a weapon against poverty and hunger. It has really changed people's lives especially the poor. Therefore the regulation and supervision of FASLC should be such that the bank does not face stringent rules and regulations to make it fold up. Nevertheless that does not mean FASLC should be allowed to do their own thing.

5.3 Recommendations

The following recommendations are therefore made to enhance the performance of FASLC in particular and all other microfinance institutions in Ghana.

5.3.1.1 Recommendations for protective measure

Deposit insurance can substantially raise confidence in the safety of deposit. It is a good idea to set up a deposit guarantee fund to cover deposits up to a certain sum. This protects microsavers who would be hardest hit by deposit loss.

Compared with an implicit safeguarding of depositors accounts (ie without a legal guarantee) by government, such a fund is better because it does not discriminate against small banks (whose collapse would have hardly any political effects). In additions, it is a more effective way of mitigating the danger of a run and possible losses are not socialized via taxes.

Suggestions have also been made to subsidise or fully finance such a fund from government coffers, since promoting the microfinance sector is in the public interest. Altogether, little discussion has been devoted to safeguarding depositor's accounts in microfinance till now and there is an urgent need to gain practical experience.

The financial crisis in Indonesia highlighted the role of protective measure and compelled the government to take rapid action. A major element in the program to restructure the banking sector is the Indonesian Government Guarantee, which alongside deposits also covers a whole range of the banks liabilities. The aim is to restore confidence in the banks.

5.3.1.2 Recommendations for preventive measure

The conditions for a prudential regulation of MFI's is keeping its target-group orientation. The danger particularly with preventive measure is that MFI's are pressured by inappropriate regulation to imitate the traditional business practices of banks.

This would run counter to the aim of deepening the financial system by intergrating microfinance. The best way to ensure this target-group orientation is to create a regulatory framework tailored to the special risk profile of MFI's.

Preventive measures include quantitative regulations on authorization of the financial institution and during regular business (ratio management) and qualitative regulations on business activities largely connected with risk management.

The minimum capital requirement for banks usually places a high barrier to entry for MFI's, as they are rarely able to raise the customary amount for traditional financial institutions and because due to the small loan amounts an inordinate number of clients would be necessary to attain an adequate leverage.

Consideration should therefore be given to whether or not at least part of the net present value of the existing loan portfolio (ie. less provisions and allowance for expected inflation) should be acknowledged in the capitalization of MFI's as was the case with PRODEM/Banco SOI in Bolivia.

Another point under ratio management is maintaining requisite **provisions** and **writing off** non-performing loans. Both incur costs for the financial institution and diminish the value of assets and also the asset –to-equity ratio. Due to higher volatility of loan portfolio quality and the shorter loan periods, reserves should be generally more conservative and write-offs made earlier than in traditional financial institutions, while catering for different loan terms.

At least upwards of a certain loan amount, consideration should be given to accepting alternative security arrangements, such as personal guarantees, movable securities or issuing group loans.

Another important factors for the regulatory institution may be monitoring performance indicators over time. When granting a licence, it can for example require a MFI to provide evidence of a 'track record' ie of successful past performance, as envisaged by the regulation proposal in Uganda.

Ban on insider business: With insider business there is the danger that loans are granted for other than economic reasons or owners try to recover their equity capital by borrowing from the MFI and thus undermine capital requirements.

5.3.1.3 Regulation and supervision of MFI

While sound practices of micro-finance call for interest rate deregulation and a freedom for MFI's to adapt to local conditions, regulators must ensure that barriers to entry into the micro-finance sector are not so low that un-viable private and non-governmental organisations flood the market.

Overall, there is the need for Ghana to consider designing regulatory frameworks that do not favour either segmented regulation or universal regulation. The structure of the financial sector in Ghana should determine the tiers and levels of coordinated and consolidated regulation and supervision that need to be in place.

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APPENDIX A

KWAME NKRUMAH UNIVERSITY OF SCIENCE AND TECHNOLOGY (KNUST) SCHOOL OF BUSINESS

FASLC QUESTIONNAIRE

This questionnaire is designed to examine how First Allied Savings and Loans Company a micro finance institution is being regulated in the Kumasi Metropolis. The result of the study is purely for academic purposes and any information provided will be treated with the necessary confidentiality.

INSTRUCTION:- Please tick ( ) where appropriate

1. Name of Respondent ....

2. Position in the organization ....

3. What form of collateral security do you require before granting credits to clients

   (i) Physical { } (ii) Social { } (iii) Savings { }

   (iv) Guarantee { } (v) Other(s) Please specify________________

4. Please show your organizations policy of making provision for a loan by placing " " next to the statement that is true for your organization.

______ We make provision based on overdue loans.

______We make provision based on credit history.

______ We make provision based on size of the loan

______ We make provision based on repayment capacity.

5. What percentage of provision do your provide for loans?

(i) 5% { } (ii) 10% { } (iii) 20% { } (iv) Other(s),

Please specify____

6. What type of report do you submit to the Regulatory Body? Please tick " " where necessary.

______ Liquidity Returns

______ Statement of Assets and Liabilities

______ Large Exposures

______ Loans Analysis

______ Overdrafts

______ Capital Adequacy

7. At what time do you ~~send such~~ reports?

(i) Weekly { } (ii) Monthly { } (iii) Quarterly { } (iv) Biannually { }

(v) Annually { } (vi) Other(s) Please specify______________________________

8. What product are you permitted under the regulations to deal in

_______ To operate Savings Accounts.

_______ To operate Fixed Deposit Accounts

_______ To operate Susu Schemes

Please specify other areas of operations where necessary ____________________

9. How is cheque clearing system done in your organization? Tick where necessary.

______ Through Commercial Banks

______ Through other Savings and Loans Company

______ Through Bank of Ghana

If none of the above, please specify ____________________________________

10. How many times in a year do you monitor and review the portfolio of credit and other risk assets.

(i) Weekly { } (ii) Monthly { } (iii) Quarterly { } (iv) Biannually { }

(v) Annually { }

(b) If none above, please specify ____________________________

11. What many times within a year has the Bank Supervision Department of Bank of Ghana audited your accounts.

(i) Once a year { } (ii) Twice a year { } (iii) Thrice a year { }

12. What is the composition of Board Members in your organization? Tick where necessary.

(i) 5 members { } (ii) 10 Members { } (iii) 15 members { }

13. How do you appoint Board Members? Tick where necessary.

_____ Previous banking experience

_____ Having resources to set up a bank

_____ Personal knowledge of a board member

_____ Relatives

If none of the above, please specify____

14. Do you have an effective internal control to ensure that insider lending is restricted?

(i) Yes { } (ii) No { } (b) If No please specify__________________________

15. Which areas of operation are you not permitted to operate? Please tick where necessary

_____ Not to engage in commercial activities

_____ Not to engage in agricultural activities

_____ Not to engage in real estate investment

16. Is Bank of Ghana happy with the general performance of your bank?

(i) Yes { } (ii) No { }

(b) If No please specify ____

If Yes please specify____

17. Any other comments on your operations?

APPENDIX B

KWAME NKRUMAH UNIVERSITY OF SCIENCE AND TECHNOLOGY

(KNUST) SCHOOL OF BUSINESS

BANK SUPERVISORY QUESTIONNAIRE

This questionnaire is designed to examine how First Allied Savings and Loans Company a micro finance institution is being regulated in the Kumasi Metropolis. The result of the study is purely for academic purposes and any information provided will be treated with the necessary confidentiality.

INSTRUCTIONS:- Please tick (   ) where appropriate

1. Name of Respondent ....

2. Position in the organization..

3. What is the minimum capital requirement for savings and loans company.

   Tick "   " where necessary.

   (i) GH¢1,500,000 {   } (ii) GH¢1,800,000 {   } (iii) GH¢2,000,000

4. How do you ensure that Savings and Loan Company make the necessary provision for loans Tick "   " where necessary.

   _______ Inspection of Savings and Loans Banks

______ Frequent Visits to the Savings and Loans Company

______ Analysis of returns sent to Bank of Ghana

______ Analysis of Audited Financial Statements

5. What is the policy of the Regulatory Body with respect to the provision made for loans Tick " " where necessary.

______ Based on outstanding loan portfolio

______ Based on overdue loans

______ Based on degree of credit risk

______ Based on Non Payment Risk of Individual loan

(b) If none above, please specify____

6. What is the Capital Adequacy Ratio, maintained by Savings and Loans Company? Tick where necessary

(i) 10% {] (ii) 20% { } (iii) 30% { }

7. How is the provision graded according to risk? Please tick " " where appropriate.

(i) Current { } (ii) Sub Standard { } (iii) Doubtful { } (iv) Loss { }

8. What are the general ~~rules on~~ regulations of Savings and Loans Company. Please tick " " where necessary.

______ Minimum Capital Requirement / Entry Requirement

______ Provisioning and loan classification

______ Capital Adequacy Requirements.

_______ Collateral / Guarantees

_______ Operational Restrictions

_______ Ownership and Corporate Governance

_______ Enforcement / Sanctions

_______ Others

9. Has FASLC Complied with the regulations for the past 5 years?

(i) Yes { } (ii) No { }

10. Which area of non-compliance are you critical at. Please tick " " where necessary.

______ Provisioning and loan classification

______ Capital Adequacy

______ Operational Restrictions

______ Ownership and corporate governance

11. What form of collateral do you prescribe for savings and loans company

(i) Physical { } (ii) Social { } (iii) Savings { }

(iv) Guarantee { } (v) Other(s) please specify___________________________

12. What is the lending methodology for savings and loan company?

(i) Based on character { } (ii) Less documentation { } (iii) Productive Activity { }

13. Under which authority is FASLC operating? Tick where necessary

_____ Given License to operate

______ Regulatory Directions

14. What requirement should be fulfilled by Savings and Loans Company before commencing business. Please tick " " where appropriate.

_______ Sufficiency of title deeds / lease agreements

_______ Approvals by relevant authorities

_______ Adequacy of business premises, staff operating area, ventilation, lighting Etc.

________ Display of name and other requirements under section 8 of PNDC Law 328.

_______ Security of Premises including adequacy of alarm systems, fire Extinguishers, vaults or safes etc.

_______ Insurance – fire, burglary, fidelity guarantee,

_______ Operational plans and policies approved by the board.

_______ Accounting procedures manual. General ledger and subsidiary ledgers.

________ Capital stock or shareholders register

_______ Adequacy of staffing

_______ Capital subscribed and received

_______ Competent key personnel (managers) in place

_______ Submission of financial statement of affairs

15. What is the core lines of business for savings and loans companies. Tick " " where appropriate.

(i) Deposit-taking and lending to individuals { }

(ii) Deposit-taking and lending to groups { }

(iii) Deposit-taking and lending to business enterprise { }

(iv) Consumer Credit and hire purchasing financing { }

16. Which specific areas of risk does the Regulation seek to address. Please tick where necessary

(i) Credit risk { } (ii) Liquidity risk { } (iii) Interest rate risk { }

(iv) Market risk { } (v) Currency risk { } Operational risk { }

17. How do you ensure that the accounts of savings and loans meet the Regulatory Requirements?

(i) Through Internal Auditing { }

(ii) Through External Auditing { }

(iii) Well laid down Internal Control System { }

(iv) Qualified Personnel handling the account { }

18. How do you protect Savings and Loans Company from insider lending activities. Please tick " " where necessary

(i) Lending to connected firms of 10% { }

(ii) Lending of 5% of the institutions net worth for secured and unsecured exposures { }

(iii) Director receiving a maximum of 2% of unsecured advances { }

19. What corrective action for non-compliance of prudential requirements (eg. Minimum capital requirements) is stated in the Regulation?

(i) Dismissal of Board Members or Management { }

(ii) Management take-over by an appointed agent { }

(iii) Receivership and ultimately liquidation { }

20. Any other comments on your operations

____

____

____

____

____

APPENDIX C

Financial Statement of FASLC for 2003 to 2007

	2007 GH¢ million	2006 GH¢ million	2005 GH¢ million	2004 GH¢ million	2003 GH¢ million
ASSETS:					
Cash and short term fund	5	4	3	2	1
Advances	16	10	8	6	4
Other Assets	4	2	2	1	1
	25	**16**	**13**	**9**	**6**
Fixed Assets	**8**	**1**	**1**	**1**	**1**
TOTAL ASSETS	**33**	**17**	**14**	**10**	**7**
LIABILITIES AND SHAREHOLDERS FUND					
Deposits and Current Accounts	22.0	14.00	11.38	7.51	4.53
Other Payable & Accruals	0.3	0.10	0.10	0.10	0.10
Taxation	2.0	0.04	0.04	0.03	0.02
Dividend payable	0.5	0.20	-	-	-
Short term loans	1.0	-	-	-	-
Medium Term Loan	0.5	0.30	0.28	0.26	0.25
	26.3	**14.64**	**11.8**	**7.9**	**4.9**
Stated Capital	6.4	1.5	1.5	1.5	1.5
Income surplus	0.1	0.36	0.20	0.10	0.10
Mandatory Reserve	0.2	0.50	0.50	0.50	0.50
	33	**17**	**14**	**10**	**7**

Source: Financial Statement of FASLC.

APPENDIX D

STATED CAPITAL

	2007 GH¢ million	2006 GH¢ million	2005 GH¢ million	2004 GH¢ million	2003 GH¢ million
Issued for Cash	0.6	0.6	0.6	0.6	0.6
Other than Cash	4.9	-	-	-	-
Capitalization Issue	0.9	0.9	0.9	0.9	0.9
	6.4	**1.5**	**1.5**	**1.5**	**1.5**

Source: Financial Statement of FASLC.