



## AN ANALYSIS CHALLENGES FACED BY ZIMBABWEAN MICRO FINANCE INSTITUTIONS IN PROVIDING FINANCIAL SERVICES TO THE POOR AND INFORMAL SECTOR IN THE DOLLARISED REGIME

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### Abstract

Micro-Finance Institutions (MFIs) play a pivotal role in the provision of services to the financially excluded population, particularly the poor and the informal sector. The study investigated the reasons behind the collapse and under-performance of MFIs in a dollarized regime. A survey research design was adopted targeting all 17 MFIs in Bulawayo inclusive of those that collapsed. The major finding was that MFIs are facing funding challenges. Most of them use limited personal funds to finance their businesses. In addition, the study also revealed that MFIs have poor corporate governance structures. Management Information Systems (MIS) have not been fully exploited. The major conclusion drawn from the study was that lack of funding is the major factor hindering the growth and development of MFIs in Zimbabwe. The main recommendation was that MFIs must be adequately regulated and be encouraged to have suitable governance structures in order to attract funding.

**Key Words:** *Micro-Finance Institutions, corporate governance, Informal sector, MIS, Zimbabwe, funding.*

### 1. Introduction

Zimbabwe adopted a multiple currency regime in 2009. Thereafter, the banking sector experienced marked improvements in the intermediary role. This resulted in improved financial support to the productive sectors of the economy. Microfinance institutions have emerged as a popular and credible instrument of poverty alleviation and financial inclusion. MFIs in Sub-Saharan Africa include a broad range of diverse and geographically dispersed institutions that offer services to low income clients, NGOs cooperatives and rural banks. MFIs in Africa are dynamic and growing unlike trends in most regions around the world. Countries with a high numbers of MFIs in Africa include Kenya, Uganda, Ethiopia and Senegal and a growing number of MFIs are in Rwanda, Zambia, and Tanzania. Mozambique has low population density, poor infrastructure and limited participation of rural population in the economy makes service delivery a challenge.

A huge opportunity exist in Zimbabwe for microfinance institutions to replicate the success of those in emerging markets and build large and scalable operations. However, MFIs growth in Zimbabwe has remained stagnant since dollarization, with disturbing poor performance. Amongst recent cases of failed MFIs are Capital Base in Mutare, McDowell's and All Angels in Masvingo and Moreyields in Bulawayo, to mention a few. In 2008, at the height of hyper inflation, balance sheets of most MFIs were completely wiped out thus MFIs had to develop from scratch after dollarization. Having reached a peak of 1600 in 2003, MFIs have since gone down to a meagre 130 that is currently operational.

#### 1.1 Motivation

Micro-finance tends to thrive in developing countries where there is high unemployment and poverty as people seek to engage in informal sector activities. This is not the case with Zimbabwe where MFIs are facing challenges in providing financial services. The critical role of MFIs is poverty alleviation whereby they seek to increase employment opportunities and enhance income adequate to lift the poor above the poverty line. Their other role is to foster economic growth and development as well as financial inclusion. The fundamental challenge is that Zimbabwe has experienced a drastic decline in micro finance institutions as supported by ZAMFI statistics which indicates that MFIs have gone down to 130 in 2012 from a peak of 1600 in 2003. However, the number of those that cannot access financial services has remained high at about 70% of the total population of about 12.9 million in 2012. The dramatic collapse of MFIs is symptomatic that MFIs are facing challenges in their operations. Of the reported cases MFIs such Capital Base in Mutare, McDowell's and All Angels in Masvingo and Moreyields in Bulawayo, to mention a few collapsed after they had illegally started accepting deposits from clients to sustain operations. The collapse of MFIs which are institutions that are believed to be of importance to the economy thus warrants the investigations into the causes of their collapse so as to contain the problems they could be facing before they become critical.

#### 1.2 Research Aims

The primary objective of the study was to find out the challenges faced by Zimbabwean MFIs in providing services to the informal sector. The following secondary objectives were also pursued, to find out the sources of funding for MFIs, to investigate how competition from banks and other informal financial institutions affect MFIs, to highlight the effects

of poor management skills and corporate governance on MFIs business and to find out the importance of effective management information systems (MIS) in MFIs.

## 2. Literature Review

Alemayehu (2010), defined microfinance as a provision of financial services to low income clients or solidarity lending groups including consumers and the self-employed, who traditionally lack access to banking and related services. Similarly, according to Grameen's Trust Foundation (1999), microfinance is sometimes called the 'banking for the poor'. Analogous to Morduch (1999), the primary clientele of MFIs consists almost by definition those who face severe barriers to access financial products from conventional financial institutions. These barriers comprise mainly high operational costs, and risk factors. Related to the above, Roodman and Qureshi (2006), are of the view that the term micro finance includes the provision of a wide range of financial services to the poor: savings, insurance, money transfers, and credit. The microfinance movement to date, however, has generally favored microcredit.

### 2.1 Sources of Funding for MFIs

Rhyne (2006) states that, currently, domestic sources (personal funds and donor funds) account for 85% of microfinance funding while foreign sources account for 15%. Although 15% seems a small percentage given the amount of attention given to private entry of inclusive finance, there is a large up surging market potential for continual growth in private inclusive financing of MFIs. MFIs are facing challenges in acquiring foreign or external financing and most of them rely on domestic funding which is not easy to obtain.

According to Rhyne (2006) and Gonzalez-Vega (1997b) structuring partnerships with commercial banks are a form of financing. It is essential to ensure that solid business principles prevails and that no one of a company's business will depend on an ongoing subsidy for its success, though start-up subsidies often help reduce the risk of experimentation, but dependence on subsidy and donors will lead to operational hiccups and failure. The dependency on subsidies as a source of funding for MFIs significantly reduces the chances of success.

Christen and Rosenberg (2000) also highlighted that one alternative that some microfinance institutions have pursued is borrowing from banks. ACCION International, for example, has fostered this approach by using guarantees to develop borrowing relationships between its affiliates and commercial banks.

In addition the two authorities indicated that many other microfinance institutions, however, have preferred to investigate the possibility of mobilizing deposits from the general public.

In line with Rhne (2006), Gonzalez-Vega (1997b) as well as Christen and Rosenberg (2000), Brau (2002) Woller (2002) corroborates that in practice, there are currently several ongoing practical attempts to tap capital market investors for MFI funding. The ACCION Gateway Fund makes equity, quasi-equity, and debt investments in MFIs with a proven track record of financial sustainability. The AfriCap Microfinance Fund makes equity investments in African-based MFIs, as well as financing technical assistance for said MFIs.

### 2.2 The Effects of Competition to MFIs

Marulanda (2005) articulates that the more threatening competition to existing MFIs is not coming from informal moneylenders as in the past; but from private commercial banks and other regulated financial intermediaries. However, Dorado (1998) went on to argue that increased competition is always welcome, because competition spurs technical efficiency; competition spurs improvements in the quality of outreach and in the variety of services offered. Competition spurs actions to reduce costs that, in turn, allow lower interest rates. This has clearly happened in Bolivia. Gonzalez-Vega *et al* (1996) backs up the need for increased competition because they believe that it encourages efficiency but it also increases risk. However, the drawback of competition is that it may force some MFIs out of the market. Ironically, when exit is due to entry of better actors in the market, it is a healthy outcome. Navajas *et al.*, (2003) studied competition in the Bolivian microfinance market by focusing on two major MFIs (Casa Los Andes and BancoSol), which collectively have around 40 percent market share. The results suggest that outcome of competition is ambiguous since competition leads to innovation thereby expanding outreach. However, it reduces the ability of lenders to cross-subsidize less profitable smaller loans.

### 2.3 Effect of Poor Management Skills

According to Hudon (2006), results indicate that management performance and skills are clearly associated with financial performance. Each of the four dimensions which includes leadership skills, technical skills ,organizational and communication abilities provide better results for MFIs performance. Tucker (2001), Armendariz and Morduch (2005) upholds Hudson (2006) and further argue that management is a major variable in promoting growth of MFIs.

### 2.4 Poor Corporate Governance Effect on MFI Performance

Labie (2001) ascertain that the emergence of structural problems has emphasized the importance of MFIs management and governance. Indeed the MFIs community has experienced major failures, for which inadequacy of government and management is to blame. Good corporate governance can improve firm performance and help assure long-term survival (Thomsen, 2008). The issue of corporate governance has therefore been of increasing interest for microfinance as it is today considered to be one of the weakest area in the industry (CSFI, 2008). In conformity, Rock *et al.* (1998), Otero and Chu (2002) suggest importing best practices in governance from developed countries, such as board independence and shareholder ownership while Van Greuning *et al.* (1999) and Hardy *et al.* (2002) argue for better MFI regulation.

**2.5 Importance of Effective Management Information Systems (MIS) to MFIs**

MFIs usually operate in remote and rural areas and therefore, employees are predominantly not well educated. Further, MFIs have low budgets, making it difficult to build and operate Management Information Systems (MIS) that can have a positive impact. The major challenges such firms face are that MFIs are significantly different from commercial banks, existence of infrastructure issues in implementing MIS in MFIs, lack of Information and Technology (IT) support in MIS , lack of organized training in IT for the MFI employees and lack of standardization in procedures in the MIS (Ahmad ,2008).

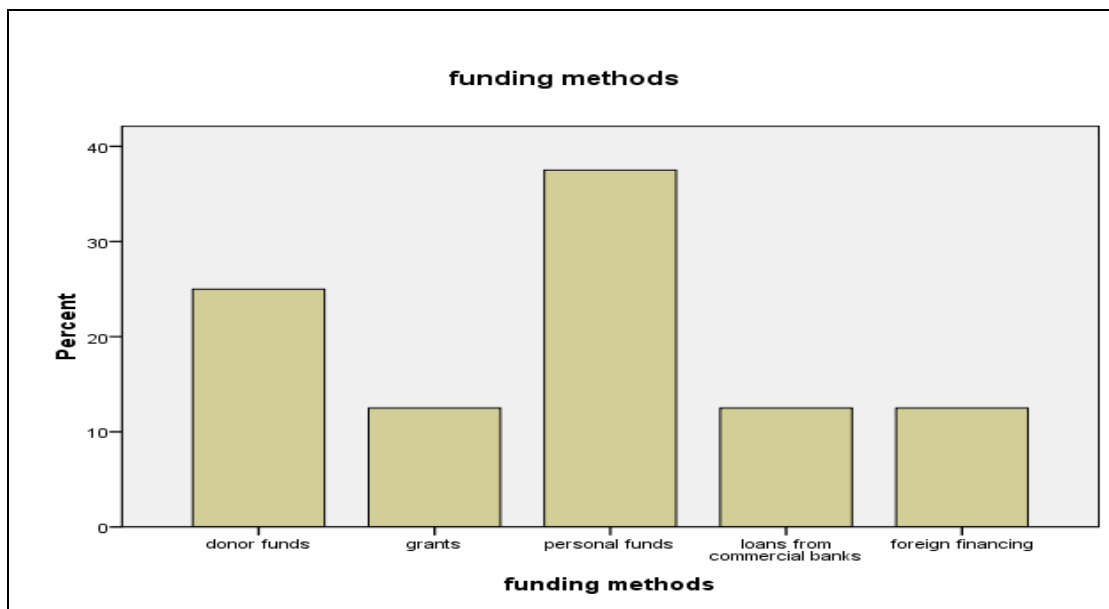
**3. Methodology**

A survey research design was used in this study. The survey strategy allowed the collection of a large amount of data from a sizeable population in a highly economical way. In addition, the survey strategy was perceived authoritative in general. The limitation to the survey strategy was the fact that data collected may not be as wide-ranging as those collected by other research strategies. There is a limit as to the number of questions that any questionnaire can contain if the goodwill of the respondent is not to be presumed on too much. To mitigate this weakness, not only questionnaires were used in the survey strategy but also personal interviews and observations. Data was collected from 17 registered MFIs including one that collapsed. The key informants were senior managers and directors. To compliment the data collected by use of questionnaires, interviews were done with the senior personnel within the Bank Supervision and Surveillance Department of the Reserve Bank of Zimbabwe as well as Executives of the Zimbabwe Association of Microfinance Institutions (ZAMFI) . The study was carried out in Bulawayo, Zimbabwe’s second largest city mainly because of limited resources since that is where the researchers are based. Data from the survey was analysed using STATA version 11. Tabulations were used to show percentages and frequencies of respondents in each response category, with cross-tabulation tables showing percentages and frequencies between two given categories.

Due to the need to maintain confidentiality some MFIs officials were not at liberty to disclose some of the relevant information as required by the researcher. To mitigate the effects several respondents from the same institutions were interviewed to produce different views of the challenges they are facing so as to have a broader objective picture.

**4. Research findings**

The research revealed that most of the MFIs are using personal funds and donor funds as a method of funding their business, with 37, 5% of the respondents stating personal funds and 25, 5% of the respondents stating loans from commercial banks and foreign financing respectively, see figure 1.



**Figure 1: Funding sources of Micro-Finance Institutions in Zimbabwe**

The other challenge identified in this research was competition from commercial banks and other financial institution, see figure 2. Approximately 50% of the MFIs attributed that their main competition rivalry are other MFIs,31,2% say that competition comes from commercial banks and 18,8% of MFIs are facing competition from other financial institution. Competition from commercial banks, to a larger extent, narrows the clientele base of MFIs and to a smaller extent it forces MFIs to offer new product design.

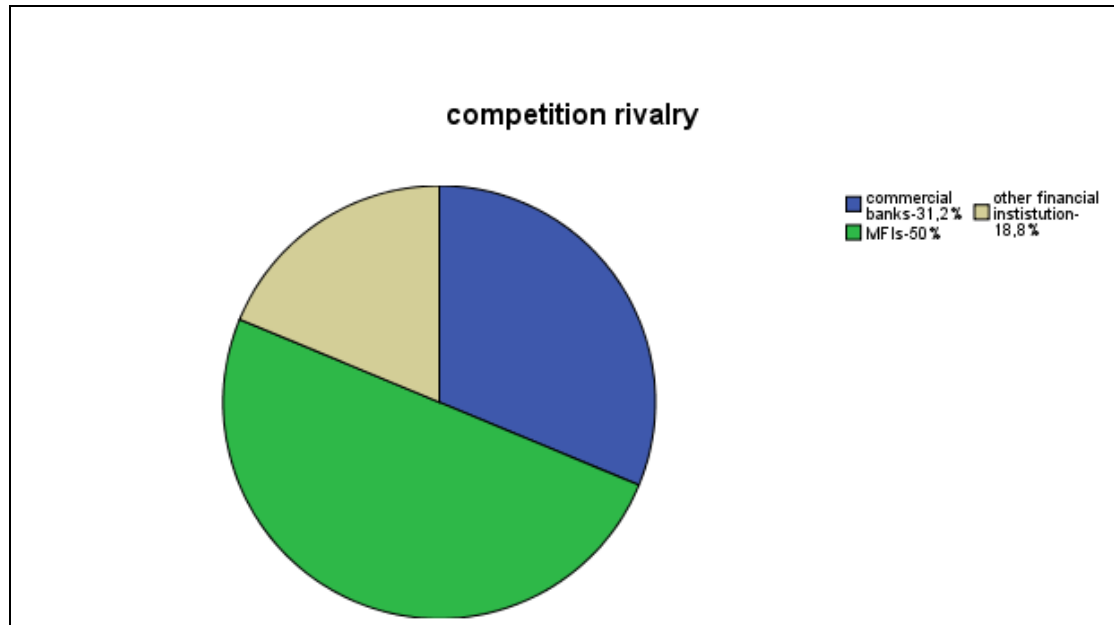


Figure 2. Competition rivalry to MFIS

Poor management skill is also another challenge which MFIs are facing in their business. From the research it was noted that 50% of MFIs use personal relationships, 43, 8% use academic qualifications and 6,2 % use a recruitment policy as a rationale for recruiting their management personnel. This can compromise decision making. Poor management skills compromises financial performance in most of the MFIs and it also affects decision making.

The researchers further asked questions on how best can corporate governance and transparency be improved in micro financing. 43, 8% favoured board independency, 31,2% supported the fact that MFIs should ensure accountability while 18% think that MFIs should be regulated, see figure 3. Most of the MFIs in this research do not carry external body inspections and this could compromise their efficiency and corporate governance. It was established that 56,2% of the MFIs are family owned and 43,8% are partnerships and in most of the MFIs (75%) the owners are also the directors , this again can compromise good corporate governance.

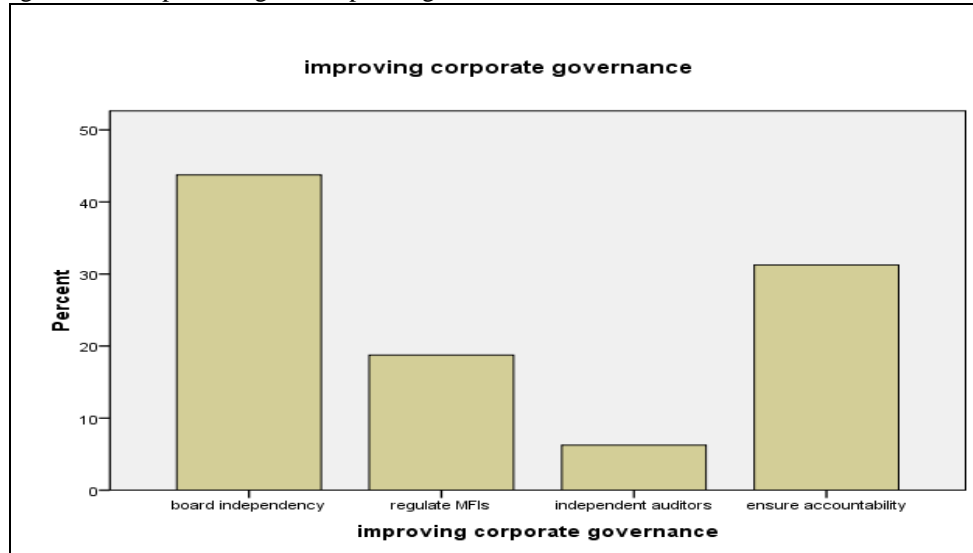


Fig 3. Methods of improving corporate governance

Most of the MFIs are facing challenges in acquiring an effective management information system (MIS). The research established that 56,2% of the MFIs are using excel spreadsheets and 18,2% are using manual/paper based systems and 25.6% are using simple packages such as loan performer. The major challenge in acquiring effective MIS is the inflexible of available packages to accommodate the highly complicated MFIs business operations.

### 5. Conclusions

It can be concluded from the research that the lack of funding is by far the biggest obstacle of MFIs growth in Zimbabwe. The researchers also concluded that competition, to a larger extent, is coming from other MFIs. However competition from commercial banks has both positive and negative effects to the performance of MFIs. Competition from banks improves efficiency and it forces MFIs to offer new product designs. On the other hand it narrows clientele base and increases loan default. Poor management skills has compromised financial performance of MFIs as it has lead to poor decision making. There is no board independency in MFIs and this lowers the financial performance of MFIs. Most of MFIs are facing challenges in acquiring effective MIS. They are thus relying on excel sheets and manual entries

which cannot be effectively manipulated to produce various reports such as debtor age analysis, excess reports and past due reports. This has resulted in poor monitoring of borrowers and high levels of bad debts.

## 6. Recommendations

MFIs have the capacity to access funds from commercial banks and they need to perfect their service delivery methods and product design to respond to the demands of their market in a rapid and efficient way, ensuring an increased volume of operations and repeat borrowing. Any donor support should encourage this additional financing and early diversification of funding sources. As banks might soon be able to provide short-term finance, donors could complement such funding during this period where there is no liquidity in the banking system with medium and long-term lines of credit. MFIs should also try to access international/ foreign funds which could be cheaper than domestic funding and also to coordinate personal funds into proper use to avoid shortage of funds. Capital markets may also work in increasing self sufficiency of MFIs.

In order to create a good management staff MFIs need to strategically deal with challenges of business e.g. defining job roles, hiring and training, monitoring employee performance, inculcating an appropriate culture to motivate staff. Thus, to a significant extent, the keys to effective MFI management are universal to business. MFIs should also use a recruitment policy or pure academic qualifications in recruiting management personnel.

MFIs must have information systems that produce clear, accurate, timely and relevant information for management decision making and that focus on well-developed loan tracking and financial reporting systems, reporting on costs and income both on a profit-centre basis and for the MFI as a whole. MFIs need to set aside budgetary allocations to acquire an effective MIS for instance those types of MIS used by international MFIs like ACCION or microfinance banks. An effective MIS should reduce transaction costs, speeding up the flow of information, analyzing the loan portfolio and provide financial reporting. In addition, there is a need to put in place strong corporate governance in MFIs because it affects financial performance.

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