

OUTREACH AND PERFORMANCE OF
MICROFINANCE INSTITUTIONS IN SUB-SAHARAN
AFRICA

BY

FAKIRA ABDISAMAD MOHAMED

A dissertation submitted in partial fulfillment of the
requirement for the degree of Masters of Science (Finance)

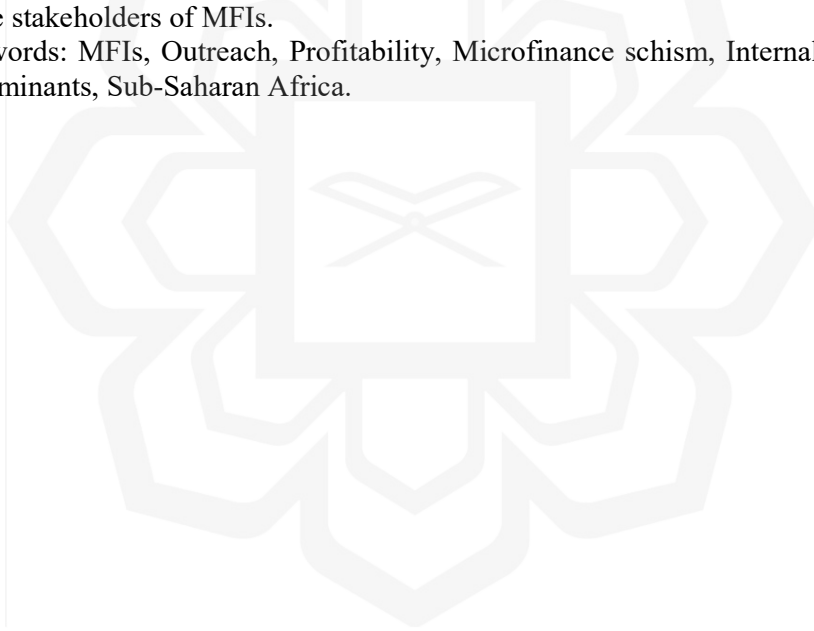
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ABSTRACT

Microfinance institution is an organization that offers financial services to the poor, unemployed or people who cannot obtain financial services from traditional banks. Most MFIs struggle to maintain balance between being profitable enough to survive on their own and outreaching great number of poor people. This study aims to investigate the internal and external determinants that influence the outreach and financial performance of MFIs in sub-Saharan Africa (SSA). A quantitative research is employed using secondary data which was collected from MIX market and World Bank. In addition, the data was gathered from 43 MFIs and the determination of the MFIs that participate in the sample was based on the fulfillment of the data for five periods of times between 2013 and 2017. The panel data was analyzed by using EViews software. The outcome in this examination is that the size of MFIs is a major determinant that impacts both social and financial performance of MFIs. In addition, the GDP growth of SSA significantly influences the operational self sufficiency of MFIs. However, GDP growth is insignificant factor in outreach. The study recognizes factors contributing to the success of MFIs as well as conveys significant information to the stakeholders of MFIs.

Keywords: MFIs, Outreach, Profitability, Microfinance schism, Internal and external determinants, Sub-Saharan Africa.



مُلخَّصُ البَحْث

تُعَدُّ مؤسسات التمويل الأصغر من أشكال هيئات التمويل التي تقدم خدمات للفقراء والعاطلين عن العمل، أو من لا يمكنهم الحصول على خدمات مالية من المصارف التقليدية، وتحاول أغلب هذه المؤسسات الموازنة بين الربحية وتقديم خدماتها لأوسع شريحة ممكنة من المساكين، وعليه؛ يهدف هذا البحث إلى النظر في العوامل الداخلية والخارجية التي تؤثر في الأداء الاجتماعي والمالي لمؤسسات التمويل الأصغر في منطقة دول الصحراء الأفريقية، وتوسَّل البحث النهج الكمي باستخدام البيانات الثانوية التي جُمعت من Mix Market والمصرف الدولي، ومن 43 مؤسسة تمويل أصغر اختيرت للمشاركة في هذا البحث بناء على اكتمال بيانات المدة ما بين عامي 2013-2017م، ثم جرى تحليل البيانات كميًا باستخدام برنامج EViews، وكانت النتائج أن حجم مؤسسات التمويل الأصغر عامل رئيس ومؤثر في الأداء الاجتماعي والمالي لهذه المؤسسات، علاوةً على أن الناتج القومي المحلي لدول الصحراء الإفريقية يؤثر تأثيرًا بالغًا في الكفاءة التشغيلية لتلك المؤسسات، ولكن نمو الناتج القومي المحلي ليس بالعامل المهم في تغطية عدد أكبر من المحتاجين، ومن ثم؛ يكشف البحث عن العوامل التي تسهم في نجاح مؤسسات التمويل الأصغر، وتقدم معلومات مهمة للمعنيين بها.

APPROVAL PAGE

I certify that I have supervised and read this study and that in my opinion, it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a dissertation for the degree of Master of Science in Finance.

.....
Khairunisah Ibrahim
Supervisor

.....
Nur Hasnida Abd. Rahman
Co-Supervisor

I certify that I have read this study and that in my opinion it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a dissertation for the degree of Master of Science in Finance.

.....
Nor Azizan Che Embi
Examiner 1

.....
Hamdino Hamdan
Examiner 2

This dissertation was submitted to the Department of Finance and is accepted as a fulfilment of the requirement for the degree of Master of Science in Finance.

.....
Sharifah Raihan Mohd Zain
Head Department of Finance

This dissertation was submitted to the Kulliyah of Economics and Management Science and is accepted as a fulfilment of the requirement for the degree of Master of Science in Finance.

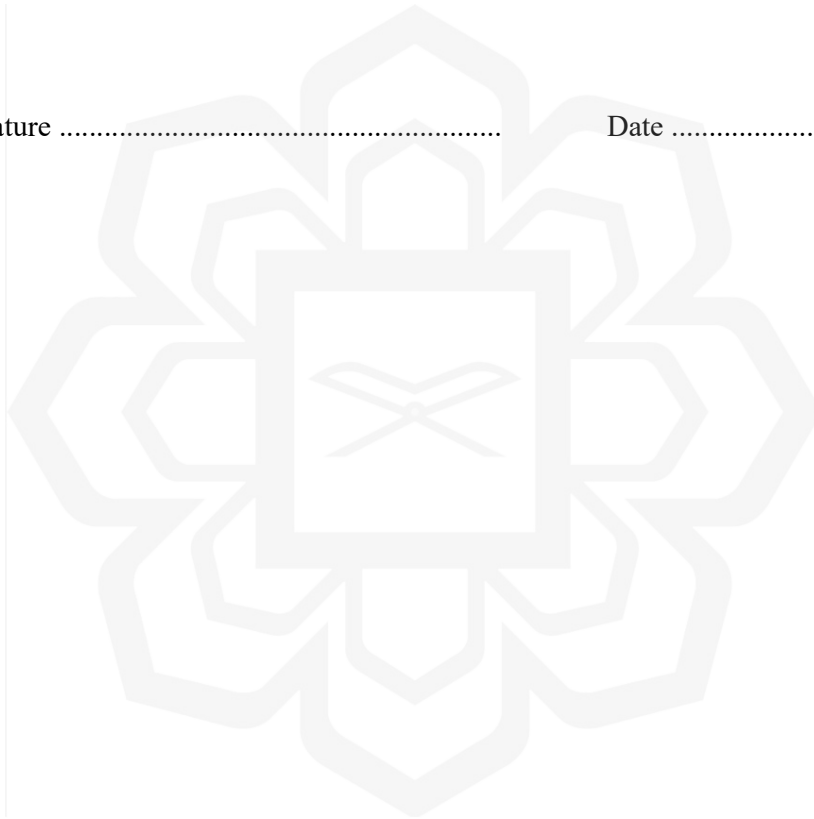
.....
Hassanuddeen Abd. Aziz
Dean Kulliyah of Economics
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DECLARATION

I hereby declare that this dissertation is the result of my own investigations, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

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CHAPTER ONE

INTRODUCTION

1.1 BACKGROUND OF THE STUDY

Poverty is regarded as one of the essential issues that developing nations face. As World Bank, (2015) illustrated, 10% of the world's population uses under \$2 per day, while 41.1% of Sub-Saharan Africa population lives on under \$1.90 per day. One of the most important causes behind this is the lack of access to loan. This is basically because of the fact that poor customers do not receive service from the banks due to lack of collaterals to secure the credit. Moreover, the operating expenses of providing financial support to the low-income individuals are excessively high for banks. Hence this caused the lack of awareness of poor population about the banks (Hermes, 2007). The removal of poor individuals from the conventional financial frameworks has denied the poor from approaching credit, and consequently some of these poor individuals began seeking credit from casual moneylenders, struggling with high rates that the moneylenders charge.

An effective strategy against poverty has been developed in the 1970s which connects the poor by offering small credit without collateral. Professor Muhammad Yunus, an economist of Bangladeshi Grameen Bank was the first to begin and pioneer the idea of microfinance in 1974 (Abdulia, 2016). Subsequently, the concept of microfinance has spread worldwide, but the effective microfinance programs exist in Asia (Farooqui, 2013). Bank Rakyat Indonesia is perhaps the largest bank in Indonesia; it focuses on lending little amount and microfinance approach to its approximately 30 million customers through more than 4000 branches (Abdulia,

2016). Microfinance institution is a contemporary approach that is intended to eliminate poverty, authorize women and generate awareness that eventually brings sustainable progress to developing nations (Hasan & Batra, 2018). In addition, microfinance is a useful program for poverty alleviation and is accomplished to take the poor people into prosperity life if it is suitably put into practice (Kasali, Ahmed & Lim 2017).

The most important goal of Microfinance institutions and their optimum promise is to outreach the poor population which means connecting to poor people by means of providing financial services in a form of sustainable support and to be profitable in order to become self-sufficient (kaupparkeakoulu, 2010). The mission that microfinance institutions strive for is eradicating poverty by offering financial supports to the needy individuals living in both urban and rustic areas; the financial services to be offered consist of saving, credit and insurance (Ojo, 2009). In addition, microfinance schemes endeavor to be financially sustainable in consideration of covering their running expenses and provide their clients continuous premise of financial service (Ledgerwood, 1999). Hence, the performance of microfinance institutions is assessed along these measurements outreach and profitability. Nevertheless, accomplishing these double objectives poses a great challenge for microfinance institutions which began to consider trade-off between the two objectives.

An argument concerning about the profitability of microfinance institutions has risen during the 1990s and is yet to be settled. Initially microfinance schemes were totally donors' endowment among small funds, restricted time phase, inadequate financial activity and restricted environmental location (Ledgerwood, 2001). In 1990s,

many donor institutions and several microfinance schemes started to discuss about the self sufficiency of microfinance associations, indicating that microfinance institutions should get the ability to cover all their expenses by the returns that their operations generate. As microfinance schemes achieve monetarily independence level, they would obtain loan from markets and cross their reliance on donors. The defenders of this theory contend this is the path for microfinance that assists in acquiring more sufficient resources to fund their activities than by depending on contributors, and along these lines to operate a totally more number of needy individuals (Morduch, 2000).

The opposite side of the discussion worries that when microfinance foundations seek to generate revenues and transform into business organizations, they will wind up serving wealthier customers who can assimilate bigger advances, and that these customers swarm out the low-income people. They fear that the idea of commercializing microfinance institutions remove the poorest customers and serve wealthier clients, despite the fact that serving poorest ones was initially the mission of microfinance (Morduch, 2000).

In Sub-Saharan Africa (SSA), microfinance segment has experienced a huge change while the executions of the money related part changes which began in 1990's. The industry has experienced a quick development in terms of the quantity of firms, land zone secured, and the quantity of clients served (Fabian & Xianzhi, 2013). The advancement of microfinance institutions in SSA were discovered in terms of the removal of low-income individuals from official banking system and the contributor support that have diverted to certain politics administrated by government authorities (Abdulai & Tewari, 2017).

In spite of the huge endeavors by the MFIs in the previous two decades, numerous MFIs in sub-Saharan Africa fail to meet expectations and battle to endure. The breakdown of Pride Zambia in 2009 and the disappointments of more than 30 MFIs in 2013 in Ghana brought the point of budgetary manageability of the microfinance business to a more extensive open banter. Indeed, even after these occasions, numerous MFIs in SSA still rely upon critical providers subsidizing to endure, which implies they are still not monetarily sustainable. (Hermes and Lensink, 2011).

As most microfinance institutions in sub-Saharan Africa failed to achieve their objectives, this study aims to explore the internal and external factors that influence the performance of microfinance institutions.

1.2 PROBLEM STATEMENT

Microfinance must be profitable in order to be self-sustaining and outreach to the poor people so as to change their lives (Brusky & Bauwin, 2018).

Better performing Microfinance Institutions have the ability to generate revenues, become self-sustaining and outreach more poor people (Ahlin et al., 2011). However, accomplishing the dual mission of microfinance institutions is a challenge for them. When microfinance schemes concentrate on the profitability or financial sustainability, it is difficult for them to reach the needy. In addition, microfinance institutions that fundamentally immediate their efforts towards connecting the poorest ones can threaten their progression in offering microfinance services (Elmaksoud, 2016). Moreover, as Bera, (2018) addressed, many more Microfinance schemes failed in establishing balance of becoming profitable which is necessary for the

sustainability of the organization and being socially responsible which means outreaching poor people. In addition, Bassem (2012) indicated that most Microfinance Institutions experience the issue of accomplishing financial and social goals simultaneously.

Unsuccessful Microfinance Institutions might not contribute to the development of the economy and alleviating poverty. Moreover, failure Microfinance Institutions prevented the poor people, who are kept out from the official financial schemes; from obtaining financial supports that can assist them enlarge and expand their financial actions by overcoming poverty. Kauppakorkeakoulu (2010), illustrated that the trade-off between outreach and profitability may cause mission drift which is represented by serving wealthier clients in order to generate profit and this is against the ultimate goal of Microfinance Institutions which is poverty reduction. Gonzalez, (2006) revealed as cited in Rocha et al., (2019) 44% of Microfinance provisions are more beneficial compared to business banks.

Hermes, (2018) reveals that reaching poor individuals is very expensive and extremely poor customers will most likely be unable to deal with those higher costs. Additionally, Hermes identifies that profitability contrasts the intended goal of microfinance which is serving and supporting low-income individuals.

In addition, most of Sub-Saharan African countries are underdeveloped as well as is where the poorest population in the globe lives. Brownstein et al. (2007) revealed that microfinance institutions in sub-Saharan Africa find it hard to figure out the issue of poverty or to outreach sufficient number of poor people due to the broadness of poverty that they are experiencing.

As the goal of Microfinance Institutions is to do a valuable and long term commitment for enhancing the outreach of poor people as well as becoming self-sustaining, Hermes (2018) found that the most essential factors that influence Microfinance performance are size of the MFI, age of the MFI and institutional type. In addition, El-maksoud, (2016) revealed that the external circumstances (like the GDP per capita) encompassing the Microfinance Institution impact it's performance. Thus, this study is conducted to examine the internal and external determinants that influence outreach and financial performance of microfinance institutions in sub-Saharan Africa.

1.3 RESEARCH OBJECTIVES

The main purpose of this study is to explore the most important determinants that influence outreach and performance of Microfinance Institutions in sub-Saharan Africa, therefore, the specific objectives of the study are:

1. To investigate the internal determinants that affect the outreach of MFIs in sub-Saharan Africa.
2. To explore the internal determinants that affect the profitability of MFIs in sub-Saharan Africa.
3. To ascertain the external determinants that affect the outreach of MFIs in sub-Saharan Africa.
4. To examine the external determinants that affect the profitability of MFIs in sub-Saharan Africa.
5. To identify the determinants contributing to the success of MFIs in sub-Saharan Africa.

1.4 RESEARCH QUESTIONS

As conversed above, there is a problem, therefore, the problem elevates some questions, in order to accomplish the aim of the research, and this study will endeavor to answer the following questions:

1. What are the internal determinants that affect outreach of Microfinance Institutions in sub-Saharan Africa?
2. What are the internal determinants that affect profitability of Microfinance Institutions in sub-Saharan Africa?
3. What are the external determinants that affect outreach of Microfinance Institutions in sub-Saharan Africa?
4. What are the external determinants that affect profitability of Microfinance Institutions in sub-Saharan Africa?
5. What are the determinants contributing to the success of MFIs in sub-Saharan Africa?

1.5 SIGNIFICANCE OF THE STUDY

This study is important for three main reasons. First, it examines the current determinants that influence the financial performance of Microfinance Institutions operating in Sub-Saharan African countries. The purpose of this investigation is to enumerate to the donors and NGOs the factors that are against the success of Microfinance Institutions. Second, the identification of determinants affecting the outreach of microfinance institutions will benefit the banks and investors who are willing to start Microfinance establishments in order to eradicate the extreme poverty that sub-Saharan countries are experiencing. Finally, this study is crucial for sub-

Saharan African governments in order to arrange a superior strategy for meeting poverty alleviation goal.

1.6 SCOPE OF THE STUDY

This research is concerned with the assessment of internal and external determinants influencing outreach and profitability of microfinance institutions in sub-Saharan Africa that have worked at least five years from 2013 to 2017. The secondary data was collected from 43 microfinance institutions that are based in 15 countries of sub-Saharan Africa.

1.7 LIMITATIONS OF THE STUDY

The potential limitations that this proposed study have are:

1. Using only secondary data is not sufficient as a primary data; it may give complete and reliable information to the topic.
2. This study will use the database of only 43 microfinance institutions due to the incomplete databases that the institutions publish to MIX market.

1.8 DEFINITIONS OF TERMS

This segment provides concise deliberations of some theoretical concepts which are regularly used in this research such as, Outreach and sustainability.

1.8.1 Outreach

Outreach is connecting to poor people; it has two most common parts which are depth and breadth. Depth of outreach alludes to the destitution dimension of customers

served, while breadth of outreach alludes to the size of tasks of a MFI (Kuchler, 2011).

1.8.2 Performance

1.8.2.1 Profitability

Profitability is one of the factors that specify the success of microfinance institutions due to their financial return, financial strengths and better returns which are crucial indicators for MFIs success (CGAP, 2019).

1.8.2.2 Sustainability

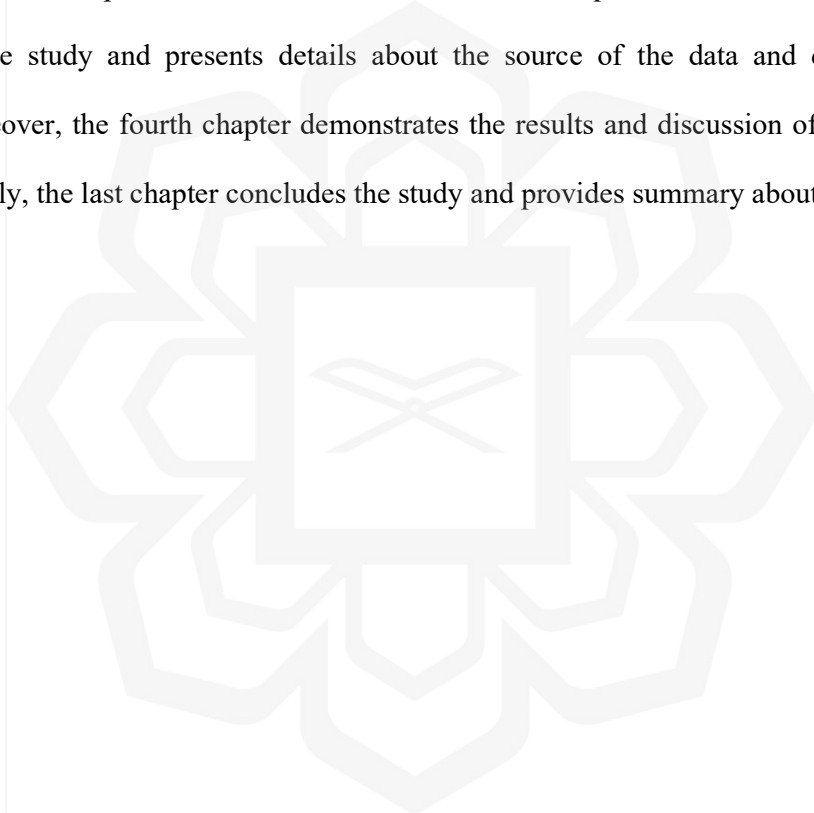
Sustainability of the Microfinance establishments alludes to the capacity of organizations to disguise of their working expenses utilizing working income produced from their core exercises (Ledgerwood, 1999). A sustainable microfinance organization provides administrations to their clients in nonstop premise, and can address the issues of individuals throughout assets obtained from tasks and outside resources (UNESCAP, 2006).

1.8.3 Microfinance Schism

Microfinance Schism is the division or disunion between mutually opposed parties the welfarist and institutionlist. The welfarist approach focuses on social execution while it's not refusing long run profitability. Institutional approach appraises that the initial great financial performance is the optimum approach to accomplish long run social performance (Berguiga et al., 2017).

1.9 ORGANIZATION OF THE STUDY

This study contains five chapters. The first chapter is the introduction; it consists of the background of the study, the problem statement, the objectives of the study, the questions of the study, the significance of the study, limitations of the study and also the organization of the study. In addition, the second chapter presents the literature review of microfinance concept, schism, performance and determinants that influence microfinance performance. Furthermore, the third chapter illustrates the methodology of the study and presents details about the source of the data and data analysis. Moreover, the fourth chapter demonstrates the results and discussion of the findings. Finally, the last chapter concludes the study and provides summary about it.



CHAPTER TWO

LITERATURE REVIEW

2.0 INTRODUCTION

This chapter reviews some previous literature related to the concept of microfinance, microfinance schism, performance of microfinance institutions, performance of microfinance institutions in sub-Saharan Africa, determinants of outreach and performance of microfinance institutions, conceptual framework of the study and a conclusion.

2.1 CONCEPT OF MICROFINANCE

Microfinance is a form of financial institution that provides financial services like saving accounts, credits, insurance and repayment services to low income people who have no access to conventional financial services due to their lack of collaterals (Ledgerwood 1998). Microfinance program is accomplished to take the poor people into prosperity life if it suitably put into practice. Microfinance is a helpful strategy for poverty alleviation (Kasali, Ahmed & Lim, 2017).

Churchill and Framkiewicz (2006) illustrated Microfinance saying that it is usually connected with little, working capital credits that are financed into small enterprises or yield productive activities. Robinson (2001) additionally characterized microfinance as little scale money related administrations essentially credit and sparing given to individuals who homestead or fish or crowd; or work little ventures or smaller scale undertakings where products are delivered, reused, fixed or sold; or provide administrations; or work for pay and commission; or increase salary from

leasing modest quantity of land, vehicles, draft creatures, or hardware devices; and other individuals and groups at the nearby degree of creating nations in both country and urban region. Moreover, Jorgensen (2012) characterized MFI as an association that gives the microfinance administrations to low pay customers.

Various foundations additionally portrayed MFI in their own particular manner. Microfinance is alluded to commonly as the arrangement of monetary administrations to those prohibited from the formal money related framework (UNCDF, 2002).

The Microfinance information exchange (MIX)¹ characterized the microfinance foundations as an assortment of monetary administrations that target low-income customers, especially ladies. Since the customers of microfinance establishments have lower salaries and frequently have constrained access to other money related administrations, microfinance items will in general be for littler fiscal sums than customary budgetary administrations. These administrations incorporate advances, reserve funds, protection, and settlements. Miniaturized scale credits are given for an assortment of purposes, much of the time for smaller scale undertaking improvement. The decent variety of items and administrations offered mirrors the way that the monetary needs of people, family units and endeavors can change essentially after some time, particularly for the individuals who live in destitution. As a result of these shifted needs, and on account of the business' attention on poor people, microfinance establishments frequently use non-conventional techniques, for example,

¹MIX is a non-profit association that offers market data and intelligence on financial service providers catering to poor populations around the globe.

bunch loaning or different types of insurance not utilized by the formal money related part (MIX, 2018).

The normal clients of microfinance administrations are merchants, road merchants, little ranchers, specialist organizations (beauticians and rickshaw drivers), craftsmen and little makers, for example, metal forgers and needle workers and have a place with the financially dynamic poor populace that are living near the destitution line, and are in this way independently employed, low-salary business people in both urban and country territories (Ledgerwood, 1999).

As expressed by Alemayehu (2008), Microfinance administrations might be found as far as four fundamental systems. Advances; permit a singular amount to be delighted in now in return for a progression of reserve funds to be made later on as reimbursement portions. Investment funds; permit a singular amount to be delighted in future in return for a progression of reserve funds made at this point. Protection; permits a singular amount to be attained at some undefined future time if necessary in return for a progression of investment funds made both now and later on. Protection additionally includes salary pooling so as to spread hazard between people on the supposition that not every one of the individuals who contribute will fundamentally get what could be compared to their commitment. Annuities; permit a single amount to be delighted in as a predetermined and for the most part removed date in future in return for a progression of investment funds made at this point.

Microfinance is a type of financial improvement that is fundamentally intended on alleviating destitution through offering financial supports to poor people. Many people consider microfinance, if by any means, as being about microcredit, loaning little measures of cash to poor people (Vanroose, 2014). Microfinance is about