Factors Affecting the Sustainability of Growth of Micro-Finance Institutions in Zimbabwe

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Abstract

Microfinance institutions (MFIs) play an important role in developing nations. The number of MFIs operating in Zimbabwe were gradually increasing against a background of unstable trends. The study sought to establish the factors that affect the sustainability of their growth. A descriptive survey research design was adopted. Out of the one hundred and seventy two MFIs which were operational in Harare, a sample of twenty three was used. The study participants comprised of middle managers, senior managers and the clients of the selected MFIs. The questionnaire was used as the main data collection tool. Literature was reviewed which looked mainly at other studies done in the related area. The study found that there were several factors that affected the sustainability of the growth of MFIs in Zimbabwe, some of them emanating mainly from the economic situation in the country. The study recommended the establishment of an effective credit rating bureau, suitable government policies, among others. The study recommended further studies to be done looking at the sustainability of the growth of MFIs in Zimbabwe, some of them ignored if financial inclusion and poverty alleviation are to be achieved in these countries [17, 9, 15]. Despite these assertions, [7] notes that the trend of MFIs operating in Zimbabwe has been declining. Table 1 below shows the trend of MFIs operating in Zimbabwe since 2003.

Table 1: Trends of the Number of MFIs in Operation in Zimbabwe

<table>
<thead>
<tr>
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<tbody>
<tr>
<td>Number of MFIs in operation</td>
<td>1600</td>
<td>200</td>
<td>309</td>
<td>150</td>
<td>27</td>
<td>172</td>
</tr>
<tr>
<td>Percentage Increase/Drop</td>
<td>-87.5%</td>
<td>+54.5%</td>
<td>-51.5%</td>
<td>-82%</td>
<td>+84%</td>
<td></td>
</tr>
</tbody>
</table>

Source: [15]

While many studies have been done covering the subject of sustainability of MFIs [18, 13, 11, 3, 6, 20], the unique dynamics of the Zimbabwean economy have not been adequately captured. The main objective of the study was to establish the factors affecting the sustainability of growth of the MFIs operating in Zimbabwe. This could be significant to investors and policy makers in this sector as it would inform the solutions to be crafted. The study focused on period 2012 having considered the time the use of the multi currency was made official.

II. Literature Review

A. Factors Affecting the Sustainability of MFIs

High default was noted in Australian credit unions with 70% of respondents acknowledging defaulting due to bankruptcy, raising questions about the credit vetting systems [21]. [5] noted an increase in bank charges by Irish lending institutions on loans to SMEs. [17] allude to appropriate policies to monitor MFIs as being an important factor to ensure success in the future. [8] seems to agree with [17] but focusing on internal controls alluding to the need for good risk management systems, audit capabilities, financial procedures and internal supervision. [3] presents an interesting finding that there are too many lending institutions which consequently affect their viability. Others factors noted by [3] were political interference which resulted in poor lending, too much emphasis on credit at the expense of non-credit supporting services and inadequate staff.

In a study done in Rwanda, [14] found that the factors that affect loan repayment behaviour were the size of the household, age, gender, purpose for which the credit was obtained for, interest charges and the number of official visits to the credit societies. [23] actually saw an opportunity being presented by the circumstances that MFIs in developing countries found themselves by arguing that they should prosper in times of recession as they are not correlated with international markets linkages and should therefore not be affected by global financial crisis, they were close to the borrowers which should reduce the risk of default. [4] however argued that the success of MFIs was related to the economic performance of the country of operation as measured by per capita income and growth, regulatory frameworks and governance, cash inflows into the country and the life expectancy at birth.

[1] suggested the existence of opportunities for MFIs based on different models of lending, arguing that models based on groups were more successful and proved that the poor were good clients as they were able to manage loans as well as save. This was supported by [6] who looked at the role of Islamic banking in...
microfinance and argued that group based lending could actually effectively reduce costs and financial risk. This seemed to be supported by the view of [20] that when more collateral was required, default rates tended to be lower. However, the case in Africa and in Zimbabwe was that there was a high percentage of the population under poverty.

[16] in conceptual paper based on India, suggested that the attitude of managers and institutional characteristics could determine the market orientation of the organizations as well as the customer satisfaction level. [18] argued that the borrower’s attitude affected credit recovery. Additionally the skills levels of the employees, their corrupt tendencies and poor government infrastructure also had a bearing. [10] in a conceptual paper noted that there were differences between the norms and values of MFIs with a profit motive and those that did not have a profit motive. Related to this [14] argued that corporate governance was a cause of the failure of MFIs.

[12] recommended MFIs to have a strategy for maintaining liquidity in disaster situations to avert failure. [11] seemed to suggest that it’s about innovativeness, arguing that there was need for add-on features for the products offered by MFIs to include life insurance, business and health education and savings products. These were noted as likely to increase the repayment rates by clients thereby ensuring sustainability. However, this did not appear feasible in the Zimbabwean context where existing financial services organizations were struggling to raise the required capital as well as liquidity problems. [2] argued that the strategy of merging financial cooperatives with each other was ideal for their future growth.

[9] noted that leverage reduced the level of outreach to the poor, since it increased the cost of capital resulting in high costs of borrowing. This in turn affected the default rates.

[13] found that most MFIs used high gearing from long terms sources of finance for their operations. This coupled with the firms lending to more clients reduced risk. However, [22] in a case study in India found that the drivers of the costs of transactions were mainly field worker remuneration, the number of groups each worker dealt with and the collection activities.

III. Methodology

The study combined the survey and descriptive research designs as answers to structured questions were solicited and a description of the situation on the ground was made. Both quantitative and qualitative data collection approaches were used. According to [7] the population of MFIs in Zimbabwe was one hundred and seventy two (172). Seventy (75) MFIs were located in Harare. The study focused on these seventy five MFIs located in Harare. The target population comprised of clients, middle managers and senior managers of these organizations. These were considered as having the relevant information that was being sought. Simple random sampling was used to select 30.7% of the 75 MFIs that participated in the study resulting in 23 MFIs being selected. The use of simple random to select the MFIs was justified by the fact that MFIs in Zimbabwe have homogenous characteristics. Within each MFI selected, convenience sampling was used to choose two clients from each of the organizations, and purposive sampling to choose one middle manager and one senior manager resulting in four participants per organization. The main data collection tool was a structured questionnaire as this was most ideal for the descriptive survey research design. Two different questionnaires were designed, one for the clients and the other for the managerial employees. To ensure validity and reliability of the questionnaire, a pilot study was done to ensure the suitability of the questions asked. Questions that were ambiguous and lacked clarity were rectified. The organizations that participated in the pilot study did not form part of the main study group. Ethical considerations were addressed by ensuring that the purpose of the study was clearly explained to the participating organizations. Permission was sought from the appropriate authorities, and no unorthodox means were used to solicit for information. Appointments were made with the 92 respondents during which questions were dropped, followed up through the telephone and later picked after completion. This allowed the study participants adequate time to think through the questions. The follow ups ensured a high response rate. The data collected was analyzed interpreted quantitatively using Microsoft excel spreadsheets, with inferences being made.

IV. Results

A. Response Rate

Ninety two questionnaires were sent out and sixty three were filled and returned, giving a response rate of 68%. The high response rate made the findings credible.

B. Location and Operational Structure of the MFIs

All the MFIs were formally registered; out of which three were registered family businesses and the remaining registered as incorporated companies 85% of the MFIs’ branches are located in urban areas and 15% in the rural areas. This indicated that the urban market was considered more attractive than the rural market. The sampled MFIs lacked corporate structures. There was no segregation of duties between major shareholders and executive management which could result in conflict of interest in decision making, lack of accountability and independence of senior management in running or monitoring affairs of the business concerns.

C. Number of Years in Operation

Out of the 23 Micro Finance Institutions surveyed, 56.5% had 0-2 years in operation whilst 18% had 3-5 years and another 18% had 5-10 years in operation and only 8.7% had above 10 years in operation. The results imply that a significant proportion of MFIs were in the infancy to growth stage of their experience curve, a situation that could explain the drop outs from the sector by the deteriorating trend in number of MFIs from 2003 to 2012 as depicted in table 1 above.

D. MFIs’ Clients’ Satisfaction Level

The majority of respondents in managerial positions indicated that the feedback they receive from their clients showed that they had low satisfaction levels with the services that the MFIs were offering. The reasons for the dissatisfaction were as a result of the high and prohibitive interest rates, too short loan tenure for the clients’ business models, inflexibility when it came to requests to rehabilitate/restructure loan defaulters, unprofessional debt collection strategies and non-diversified products.

E. Major driving forces of MFIs’ business

MFIs’ business capitalized on the high borrowing appetite in the market. This was coupled by low competition from the
conventional banks in the targeted market. The main attraction to clients of MFIs was mainly their ability to make prompt decisions with respect to loan applications. The findings could imply that the MFIs had no really sound and sustainable competitive advantage to justify the implementation of growth strategies.

F. External Risks
The study revealed that MFIs were exposed to several external risks beyond their control. The operation of the MFIs was under major threats stemming from the negative macro-economic environment, sub-economic capital levels, and liquidity problems in the economy in general to both MFIs and their clients and the resultant high cost of funds in the market. The sector was reeling from high default rate. The findings indicated that there were no positive growth prospects under the conditions highlighted above. The high operating costs posed further threats on profitability of MFIs directly and this affected the borrower viability which were both necessary for the sustainability of the growth of MFIs.

G. Impact of MFI Services to Clients and Zimbabwe Economy
The feedback from respondents indicated that MFIs have had negative impact to clients and to the Zimbabwean economy in general. The respondents disagreed that MFI loans have improved the businesses of micro enterprises and individual borrowers in Zimbabwe. Most reasons cited included the short term nature of facilities and high cost of borrowing. The respondents further highlighted that the recovery rate was low and there was high default rate.

H. Regulatory Framework of MFIs in Zimbabwe
MFIs were being regulated under the Money Lending Act Chapter 14 and supervised by the Reserve Bank of Zimbabwe. A specific Microfinance Act was yet to be promulgated. MFIs, being non-banking financial institutions were restricted from receiving deposits from the public. The respondents were of the view that the RBZ should relax restriction on accepting deposits and put in place regulatory and supervisory mechanisms safeguard customer deposits. Respondents suggested the need for RBZ to set up a Credit Reference Bureau and a concretionary facility for MFIs to access funds for on-lending.

I. Capital Structure
The sources of funding for the MFIs traditionally included shareholders equity, donor grants, nongovernmental organizations and private organization such as banks or holding companies. However the research indicated that donor support to the Zimbabwean MFI sector was no longer available. The main source of funding was debt capital through loans obtained from banks and other credit institutions. Bank borrowings account for an average of 68% of the injected capital whilst shareholders contribution, savings and equity combined accounted for an average of 32% of pool of capital. This indicated that MFIs were highly geared and susceptible to interest rate risk.

J. Loan Defaults
The study results showed that there was a high probability of default by MFI clients as compared to loans by banks. The major reasons cited by MFI executives, was the short term nature of MFI loans which was 30 to 60 days and did not coincide with the business models of most of their clients. Loans for 60 day tenures were available on a case by case basis only to deserving customers; however the funds could only be available at a premium. In addition to the above MFIs were charging average interest rates of 28% per month which was burdensome on the clients. Conventional banks average rate was between 15-20% per annum.

K. Financial Control
The research showed that the MFIs did not maintain proper accounting records and hence financial performance measurement was based on inadequate financial information with resort to assumptions. The respondents were not willing to disclose financial information which they considered as sensitive. Except in three MFIs out of the twenty, the institutions did not have independent monitoring and control being performed. Most MFIs did not have internal audit units to assist in assessing completeness and accuracy of financial information and records.

L. Profitability
The research results showed that on average, 95% of the MFI income was generated from interest income whilst only 5% was from non interest revenue. The results signaled high risk in the business as high reliance on interest income was not sustainable. This was because interest rates in the market were showing signs of stabilizing and clients were becoming aware that interest rates of up to 28% per month were not appropriate.

M. Cost structure
The study revealed that owing to high gearing, MFIs incurred high proportion of costs averaging 36% to service loans. One other negative phenomenon was the high bad debt expense at 15% of total costs. The composition of such high costs was unsustainable in the background of likely squeeze of interest margins and continuing liquidity constraints restraining alternative sources of funding for business operations.

N. Portfolio Quality
In this study, portfolio quality was taken to mean the maintenance of a portfolio with arrears low enough so that late payments and defaults do not threaten the ongoing viability of the institution. The results indicated that MFIs had a high percentage of loan in arrears with an average of 20% above standard of 5%, casting doubt to the sustainability of the profitable performance of these MFIs. The loan repayment rates for most of the 23 MFIs indicated an adverse loan repayment status, a position attributed to the harsh economic environment prevailing in the country. The average repayment rate for the sample was at 70%. Almost every MFI had a significant number of loan installments under-collections due to non-rigorous credit rating systems, absence of an effective Credit Reference Bureau, clients taking advantage of an inefficient litigation process and the general economic underperformance mainly being the contagion effect of an illiquid market.

O. Distribution of Loans and Advances
The results indicated that lending by MFIs in Zimbabwe was mainly skewed towards the consumer sector, at an average rate of 80% of the total borrowed at the expense of productive sector. The reason cited by various respondents was that the business models of the shunned sectors were long term in nature which was at variance with the short term working capital available in the market. This was a deviation from the traditional informal sector target market who did not qualify for loans in the ordinary banks.
V. Conclusion
The sustainability of the growth of MFIs looked gloomy mainly due to the following factors:

1. The MFIs were not being innovative and flexible partly as a result of government policy as indicated by the client satisfaction surveys.
2. Lending was mainly for consumption purposes rather than for viable business projects.
3. Broader economic factors like the general economic recession, liquidity problems, high interest rates, were affecting the prospects of these institutions.
4. The institutions were operating mainly in the urban areas as opposed to the rural areas thereby not effectively serving their purpose.
5. The client rating system was not rigorous enough before they were given loans.

VI. Recommendations
The study came up with the following recommendations:

1. An effective central credit rating bureau to be established.
2. There must be appropriate economy-wide as well as MFI-specific government policies that allow for the economy to be viable as well as the MFIs to be innovative and effective.
3. Further studies to be done based on testing the applicability of MFI lending models to the Zimbabwean scenario.

References

Patrick MANYUMBU is a career banker spanning over thirty one years of service in three different banks over the period. He has distinguished himself in credit risk domain and general banking having risen through the ranks to current senior leadership position as the Head Credit Risk for MBCA Bank Ltd a subsidiary of Nedbank South Africa. Patrick is a self starter and affable team contributor. He is a holder of a host of academic and professional qualifications most self initiated which include the following:

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2. Post Graduate Diploma in Management for Executives (University of Zimbabwe) –2010
3. Associate – Institute of Bankers Zimbabwe - 1999
4. Associate – Institute of Credit Management Zimbabwe - 2002
6. Diploma – Foundation for Business Studies (Institute of Chartered Secretaries) - 1994
7. Certificate in Management Techniques and Certificate in Business Functions (Zimbabwe Institute of Management)
 Marcus MUTANGA holds a Bachelor of Business Studies Honours degree and a Master of Business Administration degree all from the University of Zimbabwe. Additionally he holds a Master of Commerce – Accounting degree from the Midlands State University. He has close twelve years experience in Finance and Administration drawn from the Ministry of Finance, Cotton industry and Humanitarian Organizations. Currently he is a lecturer at the Midlands State University, Graduate School of Business Leadership department.

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