FACTORS AFFECTING THE FINANCIAL PERFORMANCE OF MICROFINANCE INSTITUTIONS IN THE DEMOCRATIC REPUBLIC OF CONGO

BY

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STUDENT’S DECLARATION

I declare that this research proposal is my original work and has not been presented for examination in any other college, institution, or university other than the United States International University - Africa for academic credit.

Signature…………………….                                                    Date ……………………………

Andy Loko Tuema (ID 650191)

This project has been presented for examination with my approval as the appointed supervisor.

Signature…………………….                                                    Date ……………………………

Dr. Elizabeth Kalunda

Signature…………………….                                                    Date ……………………………

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ABSTRACT

The purpose of this study was to investigate the factors affecting the financial performance of Microfinance Institutions in Kinshasa, DRC. The study was guided by three research questions which included: What are the effects of competition on the financial performance of microfinance institutions in Kinshasa, DRC? How does credit management affect the financial performance of microfinance institutions in Kinshasa, DRC? And lastly, what are the effects of regulations on the performance of microfinance institutions in Kinshasa, DRC?

The study adopted a descriptive correlational research design. The population comprised of one hundred and thirty-five (135) credit officers of MFIs in different departments that had been operating for the last five years in Kinshasa at the time of the study. A stratified random sampling technique was used to select a sample of one hundred (100) credit officers of MFIs from the total population. The data collection instrument used in this study was a structured questionnaire. The study analyzed data using descriptive and inferential statistics. The descriptive statistical analysis included frequencies and percentage distributions, mean and standard deviation while the inferential statistical analysis included Pearson Correlation and Regression analysis. Statistical Package for Social Sciences (SPSS) was used as a tool for statistical analysis and the results and were presented in figures and tables.

On the first research question regarding the effect of competition on the financial performance of MFIs, the male respondents who felt that competition affected the performance of MFIs very highly accounted for 45.8% while that of female respondents accounted for 43.2%. Findings from Pearson Correlation test indicated that there was a statistically significant positive correlation between competition and the performance of MFIs; \( r (85) = .76, p < .05 \). Linear regression analysis indicated that competition explained 83.2% of the variability in the performance of MFIs, \( R^2 = .832 \) and statistically significantly predicted the performance of MFIs, \( F (1, 82) = 15.14, p < .05 \).

On the second research question concerning the effect of credit management on the financial performance of MFIs, the proportion of female respondents who felt that credit management affected the performance of MFIs highly accounted for 13.5% while male respondents were
14.6%. Pearson Correlation test results indicated that credit management was strongly correlated to the performance of MFIs; $r (85) = .71$, $p < .05$. The linear regression analysis revealed that credit management explained 61.4% of the variability in the performance of MFIs, $R^2 = 0.614$ and statistically significantly predicted the performance of MFIs, $F (1, 82) = 7.54$, $p < .05$.

Regarding the third research question, with respect to regulation and its effect on the performance of MFIs, the proportion of female respondents who felt that regulation affected the performance of MFIs slightly accounted for 13.5% while that of male respondents was 10.4%. Pearson Correlation test showed that regulation access was statistically significantly correlated to the performance of MFIs; $r (85) = .71$, $p < .05$. The linear regression analysis indicated that regulation explained 86.1% of the variability in the performance of MFIs, $R^2 = 0.861$ and statistically significantly predicted the performance of MFIs, $F (1, 82) = 3.90$, $p < .05$.

Competition based on establishing strong client relationships and cost reduction in providing loans significantly affected the performance of MFIs in terms of profit margin while the business was still operational. Credit management based on client credit rating history and efficient credit monitoring and debt collection systems significantly affected the performance of MFIs in terms of market share. The study concluded that regulation played a critical role and significantly affected the performance of MFIs especially high licensing costs and long procedures from regulatory authorities. The study recommends that further research should be conducted to investigate the impact of government facilitation on financial market activities on the growth of MFIs in Democratic Republic of Congo. The study also suggests that further research should be conducted to investigate the impact of access to credit information on the growth of MFIs in DRC other than Kinshasa.
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My gratitude first goes to God who has given me the strength to undertake this research. I would like to express my sincere thanks to my parents for the financial support and care they gave me throughout this success in which without them I couldn’t be where and who I am. I also owe a lot of appreciation to all those who assisted me in carrying out this research. I’m grateful to my supervisor who helped me through giving me the right guidance, advice and assistance concerning the best way of doing and completing my research.
DEDICATION

I dedicate this research to my beloved country the Democratic Republic of Congo which has made me who I am, to my beloved family for always being there for me, for caring and giving me their love and in memory of my deceased brother. It is a motivation for me to do this research with hope that it will help many.
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LIST OF ABBREVIATIONS

DRC  Democratic Republic of Congo
MFIs  Microfinance Institutions
MSMEs  Micro, Small and Medium Enterprises
BCC  Central Bank of Congo
IMF  International Monetary Fund
NGOs  Non-Governmental Organizations
CGAP  Consultative Group to Assist the poor
OECD  Organization for Economic Co-operation and Development
COOPECs  Savings and Loan Cooperatives
CECI-PME  Savings, Credit, and Investment Co-operative for SMEs
BRI  Bank Rakyat Indonesia
SACCOs  Savings and Credit Cooperative Organization
RCB  Risk-based Capital
ROSCAs  Rotating Savings and Credit Associations
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CHAPTER ONE

1.0 INTRODUCTION

1.1 Background of the Study

Navajas et al. (2000), the micro-finance concept has operated for centuries in different parts of the world for example, “susus” in Ghana, “tandas” in Mexico, “tontines” in West Africa and “pasanaku” in Bolivia. Germidis et al. (1991), one of the earliest and longest serving microcredit organization providing small loans to poor rural dwellers with no collateral is the Irish loan Fund system initiated in the early 1700s by Jonathan Swift. His idea began slowly in the 1840s and became a public institution in less than one decade; there were about 300 branches all over Ireland. The primary purpose was to advance small loans with interest for short periods. Nevertheless, Dr. Mohammad Yunus is often credited to be the pioneer of the modern microfinance. However, his experiment was to lend to poor women in the village of Jobra, Bangladesh when he was still an economics professor at Chittagong University in the 1970s (Vinita, 2012).

The array of models has been developed by microfinance providers to deliver financial services to the poor and low-income. These include the Grameen Bank solidarity group, the Latin American solidarity group, the rural financial systems approach as epitomized by Bank Rakyat Indonesia’s (BRI) unit desa system, community-owned village banks, savings and loans associations, credit unions, and self-help groups (Ledgerwood, 1999). They aim to meet the dual criteria of sustainability and outreach by improving digital means (use the help of technology to provide micro services), women empowerment and increase the level of literacy among the poorest of poor.

Microfinance has established itself, in emerging and developing countries, as an integral part of their financial sector policies (Hudon, 2008). However, it is considered as one of the most promising tools in focusing on poverty, and small and medium enterprises in different developing countries. Yet, poverty in Africa is its main problem, especially in sub-Saharan
Africa. In the DRC, the poverty rate has been decreasing since 2005 to 2012 from 71% to 64% (World Bank, 2016), but remains among the highest in the world. The country is among the poorest in the world with a ranking of 176 out of 187 countries on the United Nations Human Development Index in 2015 (World Bank, 2016).

The World Bank has financed MFIs in the DRC up to $30 million (€27.3 million), with an aim to increase the availability of finance for micro, small and medium enterprises (MSMEs) in the country (World Bank, 2014). Therefore, helps to tackle the increase in poverty caused by unemployment especially among the youth. MSMEs and some individuals have started developing businesses, which have created a demand for MFIs, and then building an opportunity in the microfinance market in the DRC. However, there are only 147 MFIs in the DRC (IMF, 2014) serving just 2.5 million of MSMEs (financial inclusion blog, 2013) which represents only 3% of the entire population.

Decades ago, some highly creative non-profit-making agencies and banks put into place techniques to issue loans to some self-employed people who understand their market well, but lack conventional means to secure a loan. Lack of obtaining a loan from MFIs makes them select to whom they should give credit (Central Bank of Congo, BCC). Therefore, it is even the reason they can only serve 3% of the population.

MFIs have a big problem finding a perfect structure for its credit risk management that can help them to avoid higher defaulting rate. Therefore, it seems almost impossible for them to implement efficient credit risk management procedures like debt collection process, client appraisal, and others that can allow them to reduce the number of client default. With a perfect structure, MFIs can use their credit risk management efficiently to avoid the high defaulting rate, and stay profitable (Kitheka, 2012).

Credit risk is one of the many factors that can be used by a firm to influence demand for its products. The most significant threat, for any financial institution in the microfinance sector, is to lend money and not to be sure if it will get it back. Therefore, Credit risk management should be a concern for MFIs because most micro-credits are not secured, i.e., traditional
collateral is not often used to ensure microloans' security (Coster & Churchill, 2001). The ones covered are those who cannot afford credit from banks and other financial institutions due to their inability to provide guarantee or collateral against the money borrowed. Several banks do not give credit extension to these categories of people because of the non-repayment of interest and the high default risk in some cases the non-repayment the principal amount. Therefore, these institutions required to design sound credit management that entails the identification of existing and potential risks inherent in lending activities. Timely identification of potential credit default is important as high default rates lead to decreased cash flows, lower liquidity levels, and financial distress. In contrast, lower credit exposure means an optimal debtors level with reduced chances of bad debts and therefore financial health. According to Scheufler (2002), in today’s business environment which is dynamic and where an organization has to stay competitive by thinking tactically and strategically, risk management and improvement of cash flows are very challenging. With the rise in bankruptcy rates, the probability of incurring losses has risen.

According to Simone Schwarz (2011), in the DRC the bankruptcy rate is very high for registered MSMEs due to government regulations, taxes, and the environmental conditions in the market. However, most MSMEs are not registered. The authorities estimate that 40 percent of businesses in urban areas have no permit, and the figure is undoubtedly much higher in rural areas. They employ their family to work with them; they create the business to have only a family income to sustain the day-to-day lives, no one cares about investment or to thinking of expanding their business (OECD, 2005).

Therefore, most of them cannot sustain in the market so they go bankrupt and cannot repay the MFI’s interest and sometimes the principal amount. MFIs lack cash, lack liquidity, and they are condemned to close that is even one of the reason they are decidedly fewer MFIs in the DRC because with a high rate of bad debts an MFI cannot sustain (African Economic Outlook, 2015). Hence, the credit management is critical for an MFI to maintain in such a market.

The micro-credit sector is still under-developed in the DRC. As it is usually the case, savings and credit co-operatives replaced banks in this activity in the 1970s, and NGOs subsequently
played a significant role in financing micro-business. The crisis and the hyperinflation of the 1990s had a substantial impact on the way they operate. NGOs were no longer allowed to conduct financing operations. In September 2000, a micro-financing unit was set up in the BCC’s department for the supervision of financial intermediaries, with the fundamental role of supervising the sector. This unit wants to restructure the industry and eliminate all informal and inefficient forms of micro financing via an accreditation system because Micro-finance institutions are often very inefficient in the country. The savings, credit, and investment cooperative for SMEs (CECI-PME), for example, collect the savings of members for redistribution to them in the form of loans, on condition that they have subscribed for three months and have participated in a training programme (OECD, 2005).

It subsequently requires financial guarantees and funds covering 30 percent of the cost of the investment to grant a six- or twelve-month loan at a monthly interest rate of 5 percent in the DRC. It was the regulation adopted by the Central Bank of Congo (BCC) to force MFIs to maintain a certain level of efficiency (BCC, 2005). Moreover, today for their survival, MFIs do not have any other option than using the system adopted by the BCC so that they can sustain in the market. It has helped the few borrowers to enter into a better agreement, the sustainability of some MFIs, which could fit in and improved the production efficiency of this latter (Berenbach & Churchill, 2015).

The development of new financial products available for the borrowers came in as result of efficiency. It is evident that regulations can positively affect the performance of MFIs. But that regulation did not have only a positive effect on the MFIs performance, it has pushed out some of them, which could not comply because of the lack of enough financial resources, could not meet capital requirement fixed by the BCC. The number of MFIs in the country has reduced significantly leaving only hundreds of MFIs against millions of SMEs in a country where only 5% of the population have a bank account (Ministry of Finance, 2015), and 90% of people depending on MFIs which can serve only 3% of that number. These regulations from the BCC have created a challenging environment for most of MFIs to sustain and makes the target population by MFIs small. Therefore, they could serve only those who can present collateral or have followed a training programme and these kinds of SMEs are small.
MFIs are to compete with themselves for the small number of borrowers, while Commercial banks also offer the same services to low-income borrowers. In this competition, only well-established financial institutions (MFIs and Commercial Banks) can survive. However, service providers of microcredit have considerably increased in number. The industry growth and the market saturation are factors of the increased competition documented in many countries (Porteous, 2006). These recent developments do raise the question to know the effect that the increased competition has on the financial and social performance of MFIs (Assefa, Hermes, & Meesters, 2013). The importance of research on this issue is because several countries are integrating microfinance has one of their strategy in the poverty alleviation. Therefore, the understanding of the effect of competition can be a guide to designing policies ensuring the benefit of the poor people.

The literature review on the increased competition consequences on financial institutions is ambivalent. According to Motta (2004) on one part, a competitive environment has been pointed out as a contribution to a lower production cost, and a lower price of services and goods. Furthermore, it encourages new products development and technology efficiency. Some of these benefits of competition may be awaited regarding micro-finance. On the other part, however, many authors have mentioned the adverse effects of competition in the financial or banking industry. As it may head to lower borrower selection standards, to the weakening of bank-customer relationships and multiple loan-taking and high defaults (Stiglitz, 2000; Boot, 2002; McIntosh & Wydick, 2005).

Even though increased competition became a significant issue to the microfinance industry, there is still a limited number of studies investigating its effect. In addition, this factor can address whether higher levels of competition are associated with lower or higher outreach in respect of the number of clients served, as well as the poverty level of clients. Whether higher levels of competition are linked with higher/lower default rates; and finally, if higher levels of competition are related with higher/lower levels of efficiency and better financial performance (Assefa, Hermes & Meesters, 2013).
Since the collapse of the banking system, MFIs operating both in the formal and informal sectors have become the primary source of financial services for the country. Helmsmüller (2012) traced the origin of formal micro-finance since 1956 and observed its recent growth in serving some clients in the same manner that commercial banks do. Although a variety of MFIs exist to help clients in different parts of the country, they hardly serve more than 100,000 clients, a small number compared to a population of more than 79 million people. In general, their focus is on the group, which is already engaged in one or several small-scale activities; clients come to borrow and to invest in their operations, repay their loans after making a profit out of the investment, and borrow again in case of expansion (Helmsmüller, 2012).

According to the IMF, there are 147 MFIs and cooperatives; 59 transfer institutions; 3 electronic money institutions, and 16 forex exchange bureaus in DRC. There is neither a stock market nor a debt capital market (IMF, 2014). By end-September 2013, the size of the microfinance sector’s balance sheet was close to US$222 million with over a million accounts opened by big, medium, and small businesses; savings and loan cooperatives accounted for 60 percent of the accounts and MFIs for the remaining 40 percent (IMF, 2014). Most of the first savings and loan cooperatives (COOPECS) and MFIs operations are concentrated in the eastern part of the country. They operate under BCC regulation, with licenses being granted by the BCC, and the regulatory and prudential norms also being set by the Central Bank.

Savings and loan cooperatives have existed for a long time in the DRC; however, many failed during the crisis years of the 1990s (IMF, 2014). The micro-finance sector’s business model has mostly focused on savings and loan services. Between end-2009 and June 2013 deposits and loans more than doubled to US$144 million in deposits and to US$113 million in loans, a similar trend to that of banks. Both deposits and loans are also mostly in U.S. dollars, and activity remains highly concentrated: the two MFIs specialized in loans to MSMEs account for 51 percent of deposits and 42 percent of the credit of the entire microfinance sector (IMF, 2014).

Different MFIs claim that their micro-credit and services are improving the lives of the
Congolese people at the bottom of the economic pyramid. Although the effects of MFIs are numerous, areas, where MFIs have affected the community, are educational; micro-finance loans that enabled clients to build schools and educate their children, farming in rural areas and many other untold stories (Opportunity International, 2013). There are numerous success stories told by MFIs such as International-DRC, FINCA - DRC, ProCredit Bank- DRC, Hekima, PAIDEK, and many others, regarding the impact they have made in the lives of their clients (Marti, 2009). However, it should be noted that these effects of MFIs on the performance of MSMEs in the DRC are opinion-based and have to be examined through empirical studies.

As it has been said above, the performance of MFIs in the DRC is mostly opinion-based because it is difficult to prove it on an empirical study for most of them. The challenge faced by researchers is to establish MFIs financial performance with data coming from their financial statement because many do not have and do not publish. Therefore, it is better for researchers to study banks that offer microfinance services because it is easy to communicate with them and collect data directly from them or on secondary sources since all their data are available. Banks compose the formal microfinance sector. Thus, we will be studying banks like FINCADRC, ProCredit-DRC, RAWBANK-DRC, and ECOBANK-DRC because they are the topper banks regarding satisfaction, efficiency, and effectiveness. Nevertheless, it does not mean that their financial performances are not affected by factors like Competition since they are four at the top, Credit risk management, and Regulations.

Micro-finance institutions in the Democratic Republic of Congo have been operating without a national body for a long time (Marti, 2009). To close the gap, the Central Bank of the DRC and MFIs initiated a national association of micro-finance institutions (Helmsmüller, 2012). The primary goal of the “Association Nationale des Institutions Micro Finance (ANIMF)” is to assist the Government to regulate the micro-finance industry with a legal framework, procedures, and codes of conduct in the Democratic Republic of Congo (Marti, 2009).

The main challenges are the outreach of the poorest by the MFIs and the sustainability of MFIs in the Congolese market. The goal of this research is to factually investigate the association
between the increase in the competition, credit management, and regulations among MFIs and MFIs performance.

1.2 Statement of the problem

The lack of documented evidence measuring and monitoring the financial performance of MFIs and factors that are affecting it had been the source of considerable criticisms especially in the emerging countries. It is because many people in the developing nations like DRC where MFIs are meant to operate efficiently have not participated or used these institutions. According to the World Bank (2016), MFIs services and activities in the DRC have helped the country to reduce its rate of poverty but the country still among the poorest in the world. However, there is significant doubt about whether MFIs are serving their purpose or not. Because many writers about microfinance claim that, there is a considerable reduction of the poverty rate by MFIs; while according to the World Hunger, (2012) there are 501 million people or 47% of the population of the Sub-Saharan Africa who is still in poverty.

In many countries, bank regulators now face the challenge of determining whether to regulate the emerging microfinance sector at all. When regulation is guaranteed, it necessitates sound guidelines allowing the microfinance industry growth while ensuring the security of small savers interests and backing the financial industry integrity as a whole (Berenbach & Churchill, 2015). However, MFIs, which are formerly unregulated financial entities, have had considerable freedom to adapt operating methods to serve their target markets effectively. Therefore, it has led to developing a small but growing number of robust, specialized financial institutions, innovative delivery methods, and an extension of the financial services market (The MicroFinance Network, 2015).

In DRC, since 1970s MFIs have been working as unregulated entities and have served efficiently and effectively a large target population (OECD, 2005). Nevertheless, in the 1990s with the hyperinflation in the economy the BCC found necessary to regulate MFIs that has led to reducing the number of MFIs in the country, therefore, the limitation of their outreach to the
neediest (African Economic Outlook, 2008). Thus, MFIs serve mostly SMEs than individuals to comply with the BCC new regulations.

Credit risk management is a particular concern to MFIs because most microfinancing is unsecured, traditional collateral is not often used for microloans’ security (Churchill and Coster, 2001). However, it is the same with MFIs in DRC; they fear an increase in the defaulting rate caused by the inefficiency of the credit risk management. MFIs have failed to apply the credit risk management procedures to perform well financially. With inefficient methods, they fail to gather necessary information about their clients and to establish a debt collection process that could help them to avoid high default rate and to stay profitable.

According to Motta (2004), a competitive environment has been shown as a contributor to a lower production cost and a lower price of services and goods. Furthermore, it encourages the development of new products and efficient technologies. However, several authors have mentioned the adverse effects of competition in the financial or banking industry. Just as it may lead to lower borrower selection standards, to the weakening of bank-customer relationships and many multiple loan-taking and high defaults (Stiglitz, 2000; Boot, 2002; McIntosh & Wydick, 2005). Competition in the DRC has forced MFIs to reduce their outreach to the poor and to opt only for clients entitled to low risk (Central Bank of Congo, BCC). Despite the fact that smaller commercial MFIs are extending their services to these rural areas though, it is not of sufficient magnitude. The financial needs of smallholder farmers and the rural poor are mostly unfulfilled.

The proposed study, therefore, aims to investigate factors affecting the financial performance of MFIs in Kinshasa, DRC.

1.3 Purpose of the Study

The purpose of this study is to investigate the factors that affect the financial performance of microfinance institutions in Kinshasa, Democratic Republic of Congo.
1.4 Research Questions

The study will specifically try to provide answers to the following three research questions:

1.4.1 What are the effects of competition on the financial performance of microfinance institutions in Kinshasa, DRC?

1.4.2 How does credit management affect the financial performance of microfinance institutions in Kinshasa, DRC?

1.4.3 What are the effects of regulations on the performance of microfinance institutions in Kinshasa, DRC?

1.5 Significance of the Study

The result of this study will be valuable to researchers, scholars, and practitioners, as it would form a basis for further research as demonstrated below.

1.5.1 Researchers

This study will make several contributions to both knowledge building and practice improvement in credit management, competition, and regulations on financial performance. Researchers will also use the findings of this study to embark on a related study. In other terms, the study findings in this research will act as a reference for other future researchers. The researcher will also acquire necessary skills of data collection, interpretation, analysis, and discussion and this will help him in carrying out similar research in the future.

1.5.2 Scholars

The Scholars would use this study as a basis for discussions on credit management, competition, and regulations on the financial performance of MFIs. It will provide the scholars with factual studies that they may use in theirs. The study will also contribute to the body of
knowledge in the finance discipline by tiding over gaps in competition, credit management, and regulations research in general.

1.5.3 Planners and Decision makers

The information will be useful for planners and decision makers in different institutions dealing with microfinance program. Therefore, findings and recommendations could also be helpful to Small-scale enterprise managers in determining the usefulness of microfinance towards development and growth of their enterprises.

1.6 Scope of the Study

The proposed study will be conducted in the Democratic Republic of Congo but will be taking the case of Kinshasa the capital city. The area is in the west part of DRC with the highest population in the country, and where there is easy accessibility with microfinance and microfinance institutions. However, where, unfortunately, less than 10% of the population has access to essential financial services (Opportunity International, 2011:1).

The proposed study content is mainly involved with finding out factors affecting microfinance institutions and what are their effects on the performance of microfinance institutions. The study will also focus on finding out indicators that measure the performance of microfinance institutions and how negatively or positively these factors affect them in the area of Kinshasa in DRC.

The proposed study will be conducted within two semesters or seven months to gather the information that adequately meets the study objectives efficiently. The study shall base on the data within five years as the most relevant data for better analysis and comparison purposes.
1.7 Definition of Terms

1.7.1 Microfinance institutions

It is an organization that offers financial services to low-income populations. Almost all give loans to their members, and many offer insurance, deposit, and other services. MFIs can also be defined as an organization that provides financial services to the rural and micro enterprises sector including savings mobilization, provision of credit as well as extending payment to cover a large part of low-income earners particularly in rural areas with the objective of poverty alleviation (Microfinance gateway, 2000).

1.7.2 Small-scale Businesses

Small-scale Businesses are privately owned corporations, partnerships, or sole proprietorships that have fewer employees and less annual revenue than a regular-sized business or organization. What companies are defined as "small" regarding of being able to apply for government support and qualify for preferential tax policy varies depending on the country and industry (Punch Newspaper, 2017).

1.7.3 Financial performance

Financial performance is used as to measure the results of a firm’s policies and operations in monetary terms and results are reflected in the firm’s return on investment, return on assets and value added. It is essentially the action of achieving in relation to predetermined goals and objectives (Jacobson, 1999).

1.7.4 Credit management

It is described as methods and strategies adopted by a firm to ensure that they maintain an optimal level of credit and its effective management (Myers & Brealey, 2003).
1.7.5 Competition

It is a rivalry between two or more institutions for an object desired in common, usually resulting in a victor and a loser but not necessarily involving the destruction of the latter.

1.7.6 Regulation

Regulations are principles made by a government or other authority in order to control the way something is done or the way people behave.

1.8 Chapter Summary

This chapter begins with an introduction, which provides the background and scope of the study on the factors affecting the performance of micro-finance institutions in the DRC. The introduction consists of an opportunity that micro-finance institutions fulfill in developing countries. It is about the leverage of entrepreneurial drive on the emerging market and the role that certain factors like competition, credit management, and regulations play in the performance of micro-finance institutions. It mainly draws from research on micro-finance institutions in the emerging countries. This previous research has indicated that sometimes there can be dual effects of factors on the performance of micro-finance institutions which have either improved or worsened business performance.
CHAPTER TWO

2.0 LITERATURE REVIEW

2.1 Introduction

This section is the summary of information from the available literature in the same field of study. It will review empirical studies on factors that affect its financial performance namely competition, credit management and regulations credit in DRC and other countries.

2.2 Effect of competition on MFIs financial performance

2.2.1 Competition and Microfinance institutions

The development of microfinance in the early years, the thought to provide microloans to the poor as a strategy to poverty alleviation mainly appealed to and attracted social investors and Non-Government Organizations (NGOs). Still, microfinance has proven to be a successful and even profitable model of financial intermediation over the years. It has attracted increasing interest from profit-oriented microfinance providers, among which are also commercial banks sometimes international. Thus, Profit-oriented MFIs have become significantly indispensable, which according to some observers has also led to a change in the focus of microfinance. Therefore, from being socially-oriented "poverty lending” approach which is focusing on reducing poverty through providing financial services and funded mainly by donors, government subsidies and other concessional funds to an institution-oriented “financial systems” approach which is focusing on profitably viable financial intermediate to the poor people with an emphasis on institutional financial self-sufficiency (CGAP, 2001; Hulme and Arun, 2009; Cull et al, 2009). The increased competition among MFIs is one of the reasons following the increasing role of profit-oriented institutions, and the change of status by Nongovernmental organizations from non-profit to profit-making (commercialized) bodies.

In theory, the effect of competition on the financial and social performance of MFIs can be either positive or negative. Therefore, this calls for an empirical investigation since the outcome is not clear. Surprisingly, still, only very few studies have examined the effect of
competition on the financial performance of MFIs. Some of them are descriptive; some use more thorough econometric techniques; some look at impact directly, some take an indirect approach; some studies use country or region-specific data, some use multi-country data; most studies examine one aspect of the performance, only few look at a broader perspective; and they all use different (and sometimes somewhat ad hoc) measures of competition (Hermes, 2009).

Cull et al. (2009) describe competition in the Latin American microfinance market where the commercial approach to microfinance proceeded swiftly during the past decade. Their research paper indicates the market as witnessing rising competition, which leads to market saturation in most countries. Olivares-Polanco (2005), using anecdotal and descriptive evidence from CGAP (2001), look at the effect of competition in the microfinance sector. Olivares-Polanco applies a concentration index, studied as the market share held by the four largest MFIs in a country. Greater concentration is considered to be associated with a lower competitive environment. The analysis mainly focuses on outreach (measured by average loan size) and finds that increased competition results in lower awareness.

Navajas et al. (2003) investigate on competition in the Bolivian microfinance sector, with BancoSol and Caja Los Andes two main MFIs being their focus, which together cover around 40 percent of the total Industry. This study describes particularly the effect of the entry of Caja de Los Andes on BancoSol’s performance and behavior, as well as on the behavior of BancoSol’s customers. Their analysis results suggest that the effect of competition is ambivalent. On the one hand, it leads to innovation thereby allowing MFIs to expand outreach. On the other hand, however, it reduces the ability of lenders to cross-subsidize less profitable smaller loans. While studies cited above are merely descriptive studies, there are also a few studies that empirically investigate the impact of competition as demonstrated below.

2.2.2 The Effect of competition on financial performance’s factors of MFIs

Vogelgesang (2003) examines how competition affects loan repayment performance of Caja Los Andes in Chile. Her measure of competition is the fraction of customers of the bank with
simultaneous loans from another microfinance. The analysis implies that competition is related to multiple loan taking and higher levels of borrower indebtedness. The probability of default is also high with higher levels of debt. On the other hand, she argues that for a given level of borrower indebtedness, the likelihood of repayment at the right time is high in areas where there are top competition and high supply of microfinance services. Again, therefore, the results remain inconclusive.

McIntosh et al. (2005) examine the effects of competition among MFIs in the Ugandan microfinance market, specifically focusing on its impact on borrower behavior. In particular, they argue that due to increased competition among MFIs, in combination with non-existing formal processes of information sharing between lenders about borrowers’ credit history, borrowers will take up more loans from different institutions, leading to a lousy repayment rate and a reduction of savings. The factual analysis is based on data coming from FINCA (a large microcredit lender that provides mainly group loans), from a questionnaire among customers of group loans of FINCA, and from a countrywide survey, which includes information on the demand of credit. Competition is measured at the lending group level regarding the number, proximity, and presence of competitors providing group lending. It is assumed that the higher the presence and number of competitors and the smaller the distance to the nearest MFI, the stronger the environment competitiveness. Empirical findings of this study provide substantial evidence for the fact that more intense competition leads to multiple borrowing and a decline in repayment rates. Even though McIntosh et al. (2005) do not directly analyze the effect of competition on the financial performance of MFIs, their study indirectly points out the evidence for the potentially adverse effect of the increased competition on the performance of repayment of microfinance institutions.

Hermes et al. (2009) analyze the effect of formal financial development on the efficiency of microfinance over the period 1997-2007 using data for 435 MFIs. They argue that efficiency of MFIs in a more developed formal financial environment improves due to competitiveness. Simultaneously, reductions in cost reduce the outreach of MFIs. In their analysis, Hermes et al. (2009) apply different standard measures of financial development, such as the interest rate
margin, the private credit to GDP ratio, and the liquid liabilities to GDP ratio. The factual analysis in their paper provides support for both these effects.

Cull et al. (2009) investigate the performance of MFIs under the pressure of competition from formal banks, measuring competitive pressure by using bank penetration variables such as the number of bank branches per capita and square kilometer. The dataset they use consists of 342 MFIs located in 38 developing countries. Results indicate that MFIs faced with great competition tend to reduce the spread of their outreach but will concentrate more on the depth of outreach, i.e., smaller loans and more loans to women borrowers. However, the effect on other performance indicators, such as profitability, appears to be weak. Both Hermes et al. (2009) and Cull et al. (2009) use country-level measures of competition, rather than means reflecting competition at the institutional level.

Increased competition may start an increase in loan supply in case new institutions are entering the market. Most research has shown that increased loan supply may lead to multiple loan taking by clients, resulting in substantial debt burdens and low repayment rates (McIntosh & Wydick, 2005 & McIntosh et al, 2005). Increased competition imposes pressure on MFIs to become cost-efficient. Therefore, with increased competition, finding efficient ways of delivering services at lower costs has become a necessity for MFIs to ensure them a competitive edge. However, competition may end up increasing costs. Firstly, as argued above, competition may result in borrower taking multiple loans, higher default rates, and lower repayment performance. Lower levels of repayments and increased default rates add to the costs of lending activities of MFIs. Secondly, with increased competition in the market for microfinance, MFIs may also not only have to compete for clients and market shares, but also for capital and labor inputs. Loan officer salaries may rise and interest rates at which they borrow money and, leading to higher costs. Thus, the association between intensified competition and cost efficiency is not clear a priori.

However, the increased competition is awaited to be associated with falling profit rates. With MFIs under competitive pressure, it leads to the declining of monopoly rents and market
shares; they are expected to show lower profit rates, to the point where it is not attractive for new institutions to enter the microfinance sector.

2.2.3 Measuring competition

Here, Researchers borrow from the banking literature. Studies on competition in banking have applied a range of measures of competition. Concentration indices, such as the Herfindahl-Hirschman index, are one of the early and frequently used measures of competition, where low concentration is associated with high competition (Olivares-Polanco, 2005). The use of this measure is criticized on the ground that first, the relation between concentration and competition is not straightforward and second, that higher concentration does not always imply a lack of competition (Bikker & Haaf, 2002).

Another measure used frequently is the Panzer-Rosse (PR) measure. The PR measure is an empirical method, measuring the impact of variations in factor input prices on firm-level revenues and uses cross-sectional data to assess competitive behavior (Bikker & Haaf, 2002). An index called the H statistic shows the level of competition in an industry, that is the total of input price elasticities of the total revenue of firms with regards to their factor input prices. This index represents the level of competition within an industry, where H=0 reflects perfect competition and H=1 implies to a full monopoly situation. The PR measure is also not without limitations, yet, Koetter et al. (2008) point out that, firstly the H statistic is less relevant to investigate the evolution of competition since it doesn't vary over time, and secondly that it is a measure at the industry level, hence not allowing individual firm level measurement of competition.

A third and frequently used measure of competition in banking is the Lerner index (Angelini & Cetorelli, 2003; Fernandez de Guevara et al, 2005, 2007; Maudos & Fernandez de Guevara, 2004, 2007; Koetter & Vins, 2008; Koetter et al, 2008). This index is a firm-level measure of competition and may vary over time that is why many prefer this measure over the PR approach. The index measures the competition by examining the difference between the marginal cost of production and the output price (scaled by the output price) at the level of the firm. Between 0 and 1 lays the Lerner index. Within a perfectly competitive market, the price
is equal to marginal cost, the value of the Lerner index equals 0, whereas, in a monopolistic
market, where firms can set prices above marginal cost, the index will be close to 1 (Fernandez
de Guevara et al, 2005).

2.3 Effect of Credit Management on MFIs financial performance

2.3.1 Credit Management and Financial Performance

Sound credit management will ensure a lower capital that is locked with the debtors, and also
will reduce the possibility of bad debts. According to Edwards (1993) except if a seller is
successful in recovering those costs by way of interest charged or has built into his selling price
additional costs for late payment, then his profit can be affected by any overdue account. In
some competitive markets, firms can be tempted by the prospects of an increased market if
additional credit is given. However, unless it can be confident that other profits from increased
sales will outweigh the increased costs of the loan, or said costs could be recovered through
higher prices, then the practice is fraught with danger. Most companies can readily see losses
incurred by bad debts, customers going into liquidation, receivership, or bankruptcy. The
writing-off of bad debt losses visibly reduces the Profit and Loss Account.

Hudon (2010) analysed the relationship between management mechanisms of MFIs and their
financial performance based on three financial indicators ROA, AROA, and FSS and four
management dimensions like board governance competencies, Accounting and control,
decision making, planning budgeting and reporting competences like competencies of the top
managers, and competencies of HR management. However, the results of his analysis show
that management ratings influence drastically the MFIs’ financial performances. According to
him, however, except for the cooperatives where the management variable (specifically the
human resources management) has a negative impact on the return on asset, no organizational
structure exhibits better results for the three financial indicators. Thus, he underscored that
regulated MFIs have significantly better management ratings than non-regulated institutions.

If the credit risk policy is correctly formulated, carried out and well understood at all levels of
the financial institution, it ensures that the management maintains sound standards of the bank
loans to accurately assess the opportunities for business development and avoid unnecessary risks. In Qatar, Achou and Tengue (2008) pointed out that better credit risk management results in better bank performance. They concluded that “it is thus of vitally important for banks to practice sound credit risk management to protect investors interest and safeguard the asset of the bank.” Achou and Tengue further showed that banks with robust credit risk management policies tend to incur lower loan default.

There have been controversies and debate on the effect of credit risk management on the financial performance of banks. Some scholars e.g., (Li Yuqi, 2007; Kolapo, Ayeni & Ojo, 2012; Kinthinji, 2010; Naceur & Kandiil, 2006; Kargi, 2011) amongst others have carried out extensive studies on this topic and produced mixed results; while some found that credit risk management impact negatively on banks financial performance, some found a positive relationship and others suggest that other factors apart from credit risk management effect the performance of banks. In addition, Kargi (2011) discovered in a study of Nigeria banks between 2004 and 2008 that there is an important relationship between banks performance and credit risk management. He found that non-performing loans and loans and advances are major variables that determine a bank’s asset quality.

A study carried out by Parrenas (2005) on American Banks that failed in the 1980s found out that the consistent element in the failures was the inadequacy of the Bank’s management system for controlling loan quality. According to Iqbal and Mirakhor (2007), strong risk management practices can help MFIs reduce their exposure to credit risk and enhance their ability to compete well in the industry. The two studies have documented the existence of profit and a positive link between MFIs financial performance and credit risk management practices.

To minimize exposure to bankruptcies, bad debt, and over-reserving, firms must have greater insight into customer financial strength, credit score history and changing payment patterns. Achou and Tenguh (2008) researched on bank performance and credit risk management found that there is a significant relationship between credit risk management (regarding loan performance) and financial institutions performance (regarding profitability).
2.3.2 Non-Performing Loans and Financial institutions

NPLs are important because they affect the financial intermediation role of commercial banks which constitutes the banks’ main source of their income, and ultimately, the financial stability of an economy (Klein, 2013). Therefore, NPLs have increasingly attracted attention recognizing that a consequence of large amount of NPLs in the banking system is bank failure as well as a symptom of economic slowdown (Lata, 2014). This is largely because the financial performance of any commercial bank is measured in terms of profitability and NPLs have a direct adverse impact on the bottom line due to the provisions which the banks are forced to make on account of the NPLs (Balasubramaniam, 2013). Other researchers have argued that an increase in NPLs rate is a reflection of the credit policy failures (Saba, Kouser & Azeem, 2012). Khemraj and Pasha (2009) point out that high percentages NPLs are often related with financial crises and performance problems of banks in both developed and developing countries. Fofack (2005) relates the occurrence of crisis in the banking industry with a massive accumulation of NPLs and further, he observes that the NPLs account for an important portion of total assets of insolvent financial institutions and banks.

Mwangi (2012) points out that there is an opposite relationship between non-performing loans and banks financial performance. Furthermore, the study reported that the lower financial performance the higher the non-performing loans as measured by return on asset and vice versa. The bank financial performance depends on the management practices pertaining to nonperforming loan. It means that the improvement of the institution financial performance relies on best practices in non-performing loan management.

Khalid (2012) examines the effects of loan quality on bank performance. Using the multiple regression models to analyze; the return on assets and profitability ratios as proxies for banks profitability between the periods of 2006-07 and 2010-11 were under consideration. The results support the hypothesis that there are lower non-value-added activities that are required to process problematic loans while there is higher quality of the loan processing activities before loan approval, and thus the higher the banking operating performance will be.
Berger et al. (1997) in study of Problem Loans and Cost Efficiency in Commercial Banks linked Problem Loans with Cost efficiency, which in turn affects profitability. Non–performing loans can be treated as undesirable outputs or costs to a loaning bank, which decrease the bank’s performance (Chang, 1999). According to Kroszner (2002) nonperforming loans are closely associated with banking crises. Batra (2003) noted that in addition to the influence on profitability, liquidity and competitive functioning, NPL also affect the psychology of bankers in respect of their disposition of funds towards credit delivery and credit expansion.

2.3.3 The effect of Credit Management Variables on MFIs’ performance

To limit credit risk, it involves screening clients to ensure that they have the ability and willingness to repay a loan. To evaluate a customer as a potential borrower, MFIs use the 5Cs model of credit (Abedi, 2000). MFIs use 5Cs model to increase loan performance because they get a better view of their customers. There are capacity, capital, condition, character, and collateral.

Capacity estimate whether the cash flow of the company can service the repayment of the loan. Capital is the liabilities and assets of the business. A condition is an action plan that points out the legal and economic environment, and the degree of competition and the market for the service or product. A character is regarded as the business owners’ trustworthiness and integrity. It shows the applicant’s ability to run the enterprise and willingness to repay. Collateral is the ability to access the asset that the applicant is willing to give away in case of non-payment, or a warranty in case of loan default.

Owusu (2008) on practices of credit in Ghana (rural banks) discovered that the application of credit appraisal did not adequately evaluate the credit risk to guide the appropriate decision making. Thus, in his recommendations, it is stated that the amount of credit should be assessed carefully for identified projects to ensure sound funding. Any improvement in accessing finances have to tackle challenges that regard capital and collateral accessibility. The way to
guarantee the recovery of the money loaned is to take some loan insurance. It is a simple way of dealing with the fact of depositor funds' security.

To meet clients’ needs, MFIs need to design loan products to reduce an essential portion of default risk. Loan product features are composed of interest rate and fees, collateral requirements, repayment schedule, the loan size, and any other special terms. They have to be designed to address the specific purpose for which the loan is intended. Silikhe (2008) on credit risk management in MFIs in Kenya discovered that despite the fact that MFIs have set up necessary rules to the credit risk management, the recovery of the loan still critical to most of the institutions.

Njiru (2003) surveyed on credit risk management practices adopted by farmers in cooperatives in Embu. He found out that Saccos in Embu used only qualitative methods in evaluating the creditworthiness of their members. He concluded that there seems to be lack of professionalism in areas of credit risk management namely insider dealings, favoritism in lending and external influence. According to Gibson (2006), the management should maintain a written loan review policy that is reviewed and approved at least annually by the board of directors’ policy guideline. In addition, the policy guideline should include a written description of the overall credit grading process and establish responsibilities for the various loan review function.

As Padmanabham (1998) and Agu (1998) argued about it, loan default affects the borrower’s confidence, weakens staff morale and reduces the resource base of a bank for further lending. The cost of managing overdue loans tends to be very high, and this can reduce banks’ profitability levels. In some cases, the cost of unpaid loans is moved to other borrowers or customers where the interest margin on loans is higher.

Nair and Fissha (2010) indicated in a similar study of the Ghanaian rural banking industry that, the degree of loan delinquencies or impaired loans in an RCB’s loan portfolio is often considered the best leading indicator of the institution’s financial performance. Further, Nair and Fissha (2010) revealed among the sampled banks for more than one month, that the percentage of the loan portfolio that was in default was 16 percent. It is unacceptable and too
high given the global average of 3 percent for the worldwide microfinance industry (MIX, 2008). Kithinji (2010) in a study of the Kenyan banking industry, showed that there is an indirect relationship between profitability and non-performing loans.

Pandey (1995) argue that collection procedure aimed at increasing turn over while keeping low and bad debts within limits. Collection procedure is required because some clients do not pay the loan in time some are slower while others never pay. However, caution should be taken against stringent steps especially on permanent clients because harsh measures may cause them to shift to competitors (Van Horn, 1995). Ssemukono (1996) states that collection efforts are directed at accelerating recovery from slow payers and decreases bad debts losses. This therefore calls for vigorous collection efforts.

Aboagye and Otieku (2010) conducted a study on Credit Risk Management and Profitability in financial institutions in Sweden. The principal objective was to find out what would be the effect of credit risk management on the financial institutions’ profitability. They found that credit risk management in financial institutions has become more important not only because of the financial crisis that the world is experiencing nowadays but also the introduction of Basel II. They concluded that since granting credit is one of the principal sources of income in financial institutions, the management of the risk related to that credit affects the profitability of the financial institutions. Therefore, credit management is crucial for the cutting down or the increase of profitability in a financial institution.

Valsamakis et al. (2005) carried out a study on non-payment of loan obligations and risk to earnings or capital due to borrowers’ late. The main objective was to assess whether risk of non-repayment will result to loan default. He found that Credit risk encompasses both the loss of income resulting from the sector inability to collect anticipated interest earnings as well as the loss of principal resulting from loan defaults. Credit risk arises because of the possibility that the expected cash flows from advances and securities held, might not be paid in full. He concluded that credit risk is considered the most lethal of the risks firms face.
2.4 The Effect of Regulation on MFIs’ financial performance

The regulation effect on MFIs has been under-studied largely due to lack of data. Microfinance institutions now reach well millions of clients worldwide and achieve impressive repayment rates on loans (Cull et al, 2009). However, the rapid growth of microfinance has brought increasing calls for regulation but complying with the associated supervision and prudential regulations can be particularly costly for microfinance institutions. The significant empirical estimates of the costs of such regulation come not from microfinance or other financial institutions operating in developing countries, but from banks in industrialized countries. For example, by one estimate, the costs of complying with regulation in the United States are sizable, equal to 12 to 13 percent of banks’ non-interest expenses (Thornton, 1993; Elliehausen, 1998).

2.4.1 Regulation and microfinance institutions

When the central bank of Congo has decided to regulate MFIs, its impact could be seen with a reduction in number of financial institutions which could not fit the new regulations and nonperforming institutions due to higher capital requirements. However, MFIs that sustain, do not have the choice than to increase interest rate at 5% monthly for a loan of six to twelve months. In addition, the borrower should provide financial guarantees and funds covering 30 percent of the cost of the investment to be granted a loan (OECD, 2005).

Several studies are strongly critical of interest rate caps, because they observe that caps tend to hurt poor people’s access to credit by making it unprofitable to offer very small loans because of the high risk (which is why the interest rate is high in the first place) and the high administrative costs for administering many small loans (Helms & Reille, 2004). Many of the countries that passed legislation that mandated interest rate caps experienced decreases in the outreach to women and the poor, decreases in profitability of MFIs, and a decrease in the overall number of institutions (Christen et al, 2012).

Most studies on microfinance supervision in individual countries have found differing effects. A theoretical study of the potential effects of regulation on MFIs in Zambia found that the
considerable estimated increase in costs associated with increased regulation would severely decrease the profitability of institutions and was predicted to drive a significant proportion of institutions out of business unless they found ways to severely cut their costs (Chiumya, 2006). Another study on the regulation of MFIs in Peru concluded that changes in regulation had served as a facilitator for enhancing the development and growth of microfinance institutions (Carrasco, 2006).

Several papers have attempted to examine the effect of regulation and supervision on MFIs on a cross-country basis. Hartaska (2005) looks at MFIs in Eastern and Central Europe and finds that non-regulated institutions have higher returns on assets relative to regulated institutions. Using a larger sample size, Hartaska and Nadolnyak (2007) find that controlling for institutional variables and macro-economic across countries, regulation has no impact on financial performance, but they do find weak evidence that regulated MFIs serve fewer poor borrowers. Mersland and Strom (2009) find that regulation does not have a significant impact on social and financial performance. All of these studies have a problem which is that they are measuring regulation using a regulation dummy variable. It is difficult to explain a significant amount of variation in profitability or outreach from a single regulation variable because the variable says very little about what kind of regulation or supervision the institution faces.

Christen, Lyman and Rosenberg (2003) argue that regulated MFIs tend to have much higher market share, make larger loans, lend less to women, and have a higher share of staff concentrated in the head office (and thus fewer staff with contact with clients in the field). Therefore, it helps in keeping or increasing their profitability.

Cull, Demirgüç-Kunt and Morduch (2009), in their research pointed out that while there is no significant difference in profitability, there is significantly less outreach (larger loan sizes and less lending to women) for supervised MFIs than unsupervised ones. Therefore, their empirical analysis is consistent with the idea that supervised MFIs are compelled to curtail their outreach to maintain their profitability.
Cull et al. (2011) use four dummy variables ranging from the original basic regulatory dummy to a dummy for a regular reporting requirement. They are the first authors to use additional variables to measure the exact level of supervision. The authors find that when doing a cross-country analysis of 245 of the world’s largest microfinance institutions, increased regulation/supervision is correlated with larger loan sizes and less lending to women, but no decrease in profitability. They advance the explanatory theory that this is because profit oriented MFIs absorb the cost of regulation by cutting outreach to more expensive portions of the population. The theory is supported by their work on MFIs that are supported through non-commercial means (donations, for example), that did not see a decrease in outreach, but who did experience a drop in profitability. If supervision does have a negative impact on outreach, this is an important consideration for policy makers, given that one of the primary goals of microfinance is outreach.

Operating expense ratios for supervised institutions tend to be lower than for the unsupervised. This might seem to contradict an important part of most work done so far, namely that complying with supervision and regulation is costly for MFIs. However, operating expense ratios tend to be higher for institutions that make smaller loans and lend more to women precisely because those market segments are harder to reach (Gonzalez, 2007).

According to a study done by Atieno (2001) Commercial banks and other formal institutions fail to cater for the credit needs of smallholders, however, mainly due to their lending terms and conditions. It is generally the rules and regulations of the formal financial institutions that have created the myth that the poor are not bankable, and since they can’t afford the required collaterals, they are considered un-credit worthy. The results showed that the limited use of credit reflects lack of supply, from the rationing behavior of both formal and informal lending institutions. The study concluded that given the established network of formal credit institutions, improving lending terms and conditions in favor of small-scale enterprises would provide an important avenue for facilitating their access to credit.
2.4.2 Regulatory theory of Microfinance Institutions

There are number of ways that regulation can increase costs for microfinance institutions. Minimum capital requirements specify the minimum absolute amount that owners must invest as equity in an institution seeking a license to accept deposits. Lower start-up costs lead to more banks entering a given market. Minimum capital requirements should generally be high enough to fund appropriate infrastructure and systems and to cover start-up losses (Christen et al, 2012). Reserve requirements are another common regulatory tool. Reserve requirements are the reserves (as a percentage of deposits) that banks are required to maintain. This is mainly to make sure that banks are sufficiently liquid. Since banks are usually paid a below-market return on reserves, this kind of a requirement should, in theory, increase the cost of deposit raised capital. All else equal, this would raise the minimum deposit size that a bank can handle profitably. The bank then needs to increase revenues to offset costs. If there is a fixed cost per customer this could potentially squeeze out small depositors.

The capital adequacy ratio (CAR) is the ratio of equity to risk-weighted assets. A higher CAR means less risk to depositors and the financial system. But, a higher CAR also means less funding from deposits, which lowers profits and provides a disincentive for banks to provide savings accounts. In the long term a higher CAR could reduce poor people’s access to financial services, all else equal (Christen et al, 2012).

Interest rate caps are an artificial maximum on the interest rate that banks are allowed to charge. After controlling for market conditions, the interest rate on a loan is primarily determined by the level of risk in the loan. Since the level of risk in very small loans to the very poor is often higher, this means that the interest rates charged to the poor should be comparatively high. The other reason for this is that fixed administrative costs would be higher on a per loan basis for smaller loans. When interest rate caps are set, this means that banks may no longer be able to profitably lend to the poor. Therefore, interest rate caps have the potential to hurt poor people’s access to credit (Cull et al, 2011).
There are several reasons why costs associated with regulation are likely to be higher for microfinance institutions. First, regulation exhibits economies of scale, meaning that smaller banks face higher average costs per unit of volume than larger banks in complying with regulation (Elliehausen and Kurtz, 1988). Start-up costs of regulation exhibit even more significant returns to scale because they require a large component that demands the same amount of time and expense regardless of the scale of the bank. For microfinance institutions with little to no experience with regulation, the costs are likely to be even higher. Additionally, frequent reporting to a supervisory board may be more difficult for a MFI that is involved in a large amount of very small transactions, than for a commercial bank that has fewer, larger transactions (CLR, 2003).

Second, costs of compliance with regulatory policies may be particularly difficult for MFIs because of the high portion of skilled labor costs involved. In developing countries, the majority of the costs associated with new banking regulations are for labor. Regulation is complex and the labor necessary is likely to be managerial or legal, including needing people to monitor employee compliance and coordinate compliance reviews as well as keeping ahead of new court decisions and regulatory changes. Skilled labor is in short supply in many MFIs and is one of the larger costs (Cull et al, 2011).

Large labor components to regulation mean that new regulation can be more costly for MFIs than for traditional banks. Third, the nature of microfinance means that institutions are making small loans to a large number of borrowers. Since the administrative costs per dollar lent are higher for smaller loans than for large ones, MFIs need to charge higher interest rates or higher set-up fees to cover their costs than do conventional banks. Increased costs in any form, including regulation, mean that MFIs are forced to raise either interest rates or loans sizes. On either front, increases could exclude particularly vulnerable portions of the population such as women and the very poor.
2.4.3 Regulations or No Regulations

The vast majority of microfinance institutions are small and informal and operate as voluntary associations at the local level. It is not feasible nor desirable to regulate them. Regulators should concentrate their attention on institutions that would like to offer deposit-taking services to the general public. The fact is, very few MFIs have the combination of ownership structures, management, financial discipline, information systems and profitability that are necessary to be safe deposit takers. In most countries, there are no more than one or two institutions that might warrant regulatory attention. In exceptional cases with more mature microfinance industries, such as Indonesia, Bolivia, and Bangladesh, there may be a more significant number.

Sizwe (1997) at the Microcredit Summit in Washington pointed out that MFIs necessary to regulate are only those that mobilize voluntary savings for on lending. However, some organizations mobilize voluntary savings that do not need to be monitored.

The Regulation and Supervision of Microfinance Institutions necessary to regulate common bond institutions, such as village banks and ROSCAs, which are small enough so that all members know each other. Regulators are primarily responsible for two things to preserve the integrity of the financial system and to protect small depositors (CGAP, 2009). Almost all of the experts felt strongly that as long as MFIs do not mobilize savings from the general public, they should not be regulated. Nevertheless, it is possible to make two arguments for controlling credit-only MFIs.

First, if the MFI has access to government credit lines for on lending to the microenterprise sector, regulation may be required to ensure efficient use of public resources. This argument is questionable since wholesale lenders, whether they are public or private, should assume responsibility for monitoring their loans instead of delegating that responsibility to bank supervisors. Second, if the MFI wishes to become a deposit-taking institution in the future, regulators may want to become familiar with the organization and its capacity, thereby laying the groundwork for authorizing deposit taking at a later date. The counter-argument to this
point is based on practicality (Berenbach & Churchill, 2015). Most regulatory and supervisory agencies do not have the capacity or the resources to monitor small institutions that do not pose a threat to the integrity of the financial system. Therefore, this nice to have transition arrangement may not be practical in many countries. Overall, if regulation were deemed necessary for credit-only MFIs, then the requirements and levels of supervision would undoubtedly be less stringent than for financial intermediaries (CGAP, 2003).

2.5 Chapter Summary

The literature review on chapter two, in the first place, traced the origin and the development of micro-finance institutions. The literature review pointed out that the concept of microfinance is both old and new. Although the institutionalization of micro-finance has received popularity in the last decade, this practice has existed for centuries. We pointed out some theories, microfinance technology, challenges, and performance of MFIs in DRC and other countries. The chapter also concentrated on empirical studies about factors that affect the financial performance of MFIs as Competition, Credit management and Regulations of credit management. None of the local empirical studies that have been done on microfinance industry focus on the effect of those factors on the financial performance of MFIs, there is, therefore, a gap in the empirical evidence available. This study seeks to bridge the gap or contribute to the advancement of the research.
CHAPTER THREE

3.0 RESEARCH METHODOLOGY

3.1 Introduction

This section contains the methodology that will be used in data collection analysis and presentation of the study outcomes. Specifically, the chapter includes the study design, the population of the study, the sample size, sampling procedure and design as well as ethical consideration and limitations of the study. The chapter also contains the data collection methods, methods of data analysis and the chapter summary.

3.2 Research design

Burns and Grove (2003) describe a research design as a map for conducting a study with full control over factors that may interfere with the findings' validity. Parahoo (1997) defines a research design as a plan that describes how, when and where data are to be collected and analyzed. Polit et al. (2001) identify a research design as the researcher’s overall studies for answering the research question or testing the research hypothesis.

This study will adopt a descriptive research design. According to Burns and Grove (2003), descriptive research intends to provide a picture of a situation as it usually happens. This may be used to justify current practice and make a judgment and also to develop theories. The study seeks to describe the relationships between competition, credit management and Regulation, and their effects on the financial performance microfinance institutions regarding their profitability. This study will focus on establishing the effect of competition, credit risk management, and regulations on the financial performance of MFIs regarding their profitability in DRC, a case of MFIs in Kinshasa.

The research will be a descriptive cross-sectional survey design where data will be collected from across the population at one point in time. This model is cheap, less time consuming and easy data collection and analysis (Amin 2005). Both qualitative and quantitative data collected will be used during the data collection.
3.3 Research population

Parahoo (1997) describes population as the total number of units from which data can be collected, such as individuals, artefacts, events or organizations. Burns and Grove (2003) describe population as all the elements that meet the criteria for inclusion in a study. Burns and Grove (2003) define eligibility criteria as a list of characteristics that are required for the membership in the target population. However, Kinshasa has a population of 10 MFIs working for its community. Nevertheless, here the target population of this study consisted of credit officers from the four most significant banks offering microfinance services in Kinshasa. Classification of the MFIs considered the most significant providers of microfinance services which included FINCA-DRC, RAWBANK-DRC, ECOBANK-DRC and ProCredit-DRC that constituted a population of 25, 32, 41 and 37 credit officers respectively thereby totaling to 135 credit officers as the population distribution. The four banks possess about 80% of the market (Central Bank, 2015). Moreover, the availability of their data and the well-structured organizations made them suitable for this study. Therefore, it was easy to study their financial performance because of the availability of their financial statements published annually.

3.4 Sample Size

According to Cooper and Schindler (2014), a smaller set of the larger population is referred to as a sample size. The researcher adopted Yamane (1973) statistical formula to select an appropriate sample size from a finite population. This formula was used to determine the representative sample size from the credit officers of MFIs operating in Kinshasa as follows:

\[ n = \frac{N}{1 + Ne^2} \]

Where;

\( n \) = required sample size
\( N \) = size of the population
\( e \) = alpha level, that is, allowable error \( e = 0.05 \) at 95% confidence interval

\[ n = \frac{135}{1 + 135(0.05*0.05)} = \frac{135}{1.3375} \approx 100 \]

The study utilized a sample size of 100 credit officers of MFIs in Kinshasa. This was proportionately allocated based on the population size of each classification as shown in Table 3.1.
Table 3.1: Sample Size Distribution

<table>
<thead>
<tr>
<th>Classification of MFIs</th>
<th>Population (Credit Officers)</th>
<th>% Sample Size</th>
<th>Sample</th>
</tr>
</thead>
<tbody>
<tr>
<td>FINCA-DRC</td>
<td>25</td>
<td>25/135 × 100% = 19</td>
<td>25 / [1 + 25 (0.05*0.05)] = 23</td>
</tr>
<tr>
<td>RAWBANK-DRC</td>
<td>32</td>
<td>32/135 × 100% = 24</td>
<td>32 / [1 + 32 (0.05*0.05)] = 29</td>
</tr>
<tr>
<td>ECOBANK-DRC</td>
<td>41</td>
<td>41/135 × 100% = 30</td>
<td>41 / [1 + 41 (0.05*0.05)] = 37</td>
</tr>
<tr>
<td>ProCredit-DRC</td>
<td>37</td>
<td>37/135 × 100% = 27</td>
<td>37 / [1 + 37 (0.05*0.05)] = 33</td>
</tr>
<tr>
<td>Total</td>
<td>135</td>
<td>100%</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: Central Bank, 2015

3.5 Data Collection Methods

The data to be used in the study will be obtained from both primary sources. The primary sources will comprise the bulk of the information, which will be collected from the respondents in microfinance institutions using questionnaires. The primary data will help the researcher to have current and accurate information about how the competition, credit management, and regulations affect their financial performances to avoid bias in the study. Data will be collected using structured questionnaire.

Questionnaires will be used to determine to what extent competition, credit management, and regulations affect the financial performance of microfinance institutions regarding their profitability in Kinshasa. The questionnaires will be self-administered and closed-ended so as for saving time and enable respondents to give an appropriate choice since different options will be provided. This method of data collection is preferred for this study because it allows freedom to respondents to give their honest opinions since there will be no one to challenge their answers as it is in the case of interviews. This will provide complete confidence to respondents to efficiently answer questions asked without feeling shy or being scared. The scoring system of this instrument will be based on the five scales or Likert type scale of rating involving: 1= very low, 2= low, 3= moderate, 4= high, 5= very high.
3.6 Data Analysis Methods

The data obtained was analyzed using inferential statistical and descriptive tools. The statistical analysis of data was supplemented with the application of computer software programs such as MS Word, MS Excel and Statistical Package for Social Sciences (SPSS) tool. Descriptive analysis was carried out to determine frequency and percentage distributions, mean and standard deviation.

Inferential analysis using Correlation and regression models were also used to analyze data. Pearson Correlation was used to measure the relationship between the effect of competition, credit management and regulation on the performance of MFIs. Linear regression analysis was applied to evaluate the statistical significance on the relationship that existed between the independent variables (the effect of competition, the effect of credit management and effect of regulation) and the dependent variable (the performance of MFIs).

The values of the outcome will be presented in percentages, averages, and percentage averages. The result of the data analysis will be displayed using the statistical tools of frequency charts, tables, and graphs.

3.7 Chapter Summary

The study will assume a descriptive survey employing both qualitative and quantitative data. A population of 135 small-scale enterprises and microfinance institutions are identified from which a sample of 100 is drawn. The study will assume simple and stratified random sampling to eliminate biasness. Data will be collected from primary sources. Questionnaires will be administered to the respondents for direct information. Data will be analyzed with the aid of statistical packages and presented in tables, charts, and graphs.
4.0 RESULTS AND FINDINGS

4.1 Introduction

This chapter presents the results and findings of the study based on the three specific objectives. The first section presents the descriptive analysis of respondents’ demographic information. The second section presents findings on the effects of competition on the financial performance of MFIs. The third section presents the findings on the effects of credit management on the financial performance of MFIs. The fourth section presents the findings on the effect of regulation on the financial performance of MFIs. At the end of this chapter, the summary of the major findings is presented. A total of 100 questionnaires were administered to credit officers from the credit department of MFIs in Kinshasa. Out of the 100 questionnaires administered, 85 were filled by the respondents and returned the questionnaires. This indicates a response rate of 71% as presented in Figure 4.1.

![Response Rate](image)

Figure 4.1: Response Rate

4.2 Demographic Information

In this section, results of the demographic information sought from the respondents are presented. The demographic information included gender of the respondents, the age bracket, level of education and the years of business operation.
4.2.1 Classification of Respondents by Gender
The distribution of respondents by gender is shown in Figure 4.2. The figure shows that male respondents accounted for 56% of the respondents, whereas 44% of the respondents were female.

![Gender Distribution](image)

Figure 4.2: Classification of Respondents by Gender

4.2.2 Classification of Respondents by Age
Figure 4.3 shows the distribution of respondents by age bracket. Out of the 85 respondents, 49% were within the age bracket of 25 – 29 years, followed by 25% of respondents who were aged between 30 – 34 years and 7.1% of the respondents were below 25 years.

![Age Bracket Distribution](image)

Figure 4.3: Classification of Respondents by Age Bracket
4.2.3 Classification of Respondents by Highest Level of Education

Figure 4.4 shows the distribution of the respondents by highest level of education. The figure reveals that 69% of the respondents had graduate degrees while 24% of the respondents had post-graduate degrees. The respondents with a diploma or certificate qualification accounted 4.7%.

Figure 4. 4: Classification of Respondents by Highest Level of Education

4.2.4 Classification of Respondents by Years of Business Operation

Figure 4.5 shows the distribution of the respondents by the years of business operation. The figure shows that 48% of the respondents had operated their business between 4 to 5 years while 34% of the respondents had operated their business between 2 to 3 years. The respondents who had operated their business for a period of 5 years and above accounted for 7%.
4.3 Effect of Competition on the Financial Performance of Microfinance Institutions

This section sought to establish the relationship between competition and the financial performance of MFIs from the respondents. Competition was measured by six items namely; quality customer service, client relationship, cost reduction, number of branches, proximity of competitors and loan repayment. These items measured how competition had affected performance in terms of profit margin, turnover, market share, and asset value in the respondents MFIs.

4.3.1 Descriptive Statistics for the Effect of Competition on the Performance of MFIs

Table 4.1 presents the frequency distribution of the respondents’ level of agreement or disagreement for the effect of competition on the financial performance of their MFIs. The respondents were asked to answer the questions by indicating their opinion on given statements using a 5-point Likert scale of 1-5, where 1 = Very Low, 2 = Low, 3 = Moderate, 4 = High and 5 = Very High. The frequencies and percentages were computed, and the mean scores ranked. Effectiveness was denoted by mean scores of 3.5 and above ($M > 3.5$).

The results in Table 4.1 indicates that 49% of the respondents felt that competition based on providing quality customer service had a very high effect on the performance of profit margin in their MFI while 2.3% of the respondents felt that it had a very low effect on performance ($M= 3.82$, $SD= 0.65$). The respondents who felt that competition based on cost reduction had affected the performance of market share in their MFI moderately accounted for 11.7% while
29% of respondents agreed highly with the statement \( (M= 3.53, SD= 0.92) \). The respondents who felt that competition based on establishing strong client relationship had a high effect on the performance of sales turnover in their MFI accounted for 45.8% while 9.4% of respondents felt that it had a low effect on the performance \( (M= 3.76, SD= 0.72) \). The respondents who felt that number of branches providing loans had affected the performance of asset value in their MFI moderately accounted for 35.3% while 30.5% of respondents agreed highly with the statement \( (M= 3.65, SD= 1.32) \). The respondents who felt that competition based on proximity of competitors providing loans had a very high effect on the performance of sales turnover in their MFI accounted for 5.8% while 3.5% of respondents felt that it had a very low effect on the performance \( (M= 3.67, SD= 0.61) \). The respondents who felt that competition based on loan repayment by customers had a high effect on the performance of profit margin in their MFI accounted for 18.8% while 4.7% of respondents felt that it had a low effect on the performance \( (M= 3.51, SD= 0.95) \).
### Table 4.1: Descriptive Statistics for the Effect of Competition on the Financial Performance of MFIs

<table>
<thead>
<tr>
<th>Effect of Competition on the Financial Performance of Microfinance Institutions (MFIs)</th>
<th>%f</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>Total</th>
<th>M</th>
<th>SD</th>
</tr>
</thead>
<tbody>
<tr>
<td>Competition based on providing quality customer service has affected the performance of profit margin of your MFI</td>
<td>%</td>
<td>2.3%</td>
<td>5.8%</td>
<td>17.6%</td>
<td>24.7%</td>
<td>49%</td>
<td>100%</td>
<td>3.82</td>
<td>.658</td>
</tr>
<tr>
<td></td>
<td>f</td>
<td>2</td>
<td>5</td>
<td>15</td>
<td>21</td>
<td>42</td>
<td>85</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Competition based on establishing strong client relationship has affected the performance of sales turnover of your MFI</td>
<td>%</td>
<td>5.8%</td>
<td>9.4%</td>
<td>15.2%</td>
<td>45.8%</td>
<td>23.5%</td>
<td>100%</td>
<td>3.76</td>
<td>.727</td>
</tr>
<tr>
<td></td>
<td>f</td>
<td>5</td>
<td>8</td>
<td>13</td>
<td>39</td>
<td>20</td>
<td>85</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Competition based on cost reduction in providing loans has affected the performance of market share of your MFI</td>
<td>%</td>
<td>1.2%</td>
<td>2.3%</td>
<td>11.7%</td>
<td>29.4%</td>
<td>55.2%</td>
<td>100%</td>
<td>3.53</td>
<td>.924</td>
</tr>
<tr>
<td></td>
<td>f</td>
<td>1</td>
<td>2</td>
<td>10</td>
<td>25</td>
<td>47</td>
<td>85</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Competition based on number of branches providing loans has affected the performance of asset value of your MFI</td>
<td>%</td>
<td>2.3%</td>
<td>5.8%</td>
<td>35.3%</td>
<td>30.5%</td>
<td>25.8%</td>
<td>100%</td>
<td>3.65</td>
<td>1.32</td>
</tr>
<tr>
<td></td>
<td>f</td>
<td>2</td>
<td>5</td>
<td>30</td>
<td>26</td>
<td>22</td>
<td>85</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Competition based on proximity of competitors providing loans has affected the performance of turnover of your MFI</td>
<td>%</td>
<td>3.5%</td>
<td>9.4%</td>
<td>32.9%</td>
<td>48.2%</td>
<td>5.8%</td>
<td>100%</td>
<td>3.67</td>
<td>.613</td>
</tr>
<tr>
<td></td>
<td>f</td>
<td>3</td>
<td>8</td>
<td>28</td>
<td>41</td>
<td>5</td>
<td>85</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Competition based on loan repayment by customers has affected the performance of profit margin of your MFI</td>
<td>%</td>
<td>3.5%</td>
<td>4.7%</td>
<td>21.1%</td>
<td>18.8%</td>
<td>51.7%</td>
<td>100%</td>
<td>3.51</td>
<td>.958</td>
</tr>
<tr>
<td></td>
<td>f</td>
<td>3</td>
<td>4</td>
<td>18</td>
<td>16</td>
<td>44</td>
<td>85</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### 4.3.2 Correlation between Competition and the Performance of MFIs

Pearson Correlation test was used to test the relationship between competition and the performance of MFIs. The results in Table 4.2 indicates that there was a statistically significant strong positive correlation between competition and the performance of MFIs, \( r (85) = .76, p < .05 \).
Table 4.2: Correlation between Competition and the Performance of MFIs

<table>
<thead>
<tr>
<th>Variables</th>
<th>Competition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Performance of MFIs</td>
<td>Pearson Correlation</td>
</tr>
<tr>
<td></td>
<td>Sig. (2-tailed)</td>
</tr>
<tr>
<td></td>
<td>N</td>
</tr>
<tr>
<td>Competition</td>
<td>Pearson Correlation</td>
</tr>
<tr>
<td></td>
<td>Sig. (2-tailed)</td>
</tr>
<tr>
<td></td>
<td>N</td>
</tr>
</tbody>
</table>

*.Correlation is significant at the 0.05 level (2-tailed).

4.3.3 Regression analysis between Competition and the Performance of MFIs

A simple linear regression was conducted to establish the extent to which competition affected the performance of MFIs. The findings of the model summary presented in Table 4.3 indicates that competition explained about 83.2% of the variability in the performance of MFIs ($R^2 = .832, F(1, 82) = 15.14, p < .05$) and the strength of the relationship ($r = .804$).

Table 4.3: Model Summary

<table>
<thead>
<tr>
<th>Model</th>
<th>$R$</th>
<th>$R$ Square</th>
<th>Adjusted $R$ Square</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>.804a</td>
<td>0.832</td>
<td>0.062</td>
<td>1.72681</td>
</tr>
</tbody>
</table>

a. Predictors: (Constant), Competition

*$p < .05$

The linear regression ANOVA results presented in Table 4.4 indicates that competition statistically significantly predicted the performance of MFIs $F(1, 82) = 15.14, p < .05$. 

42
Table 4.4: ANOVA

<table>
<thead>
<tr>
<th>Model</th>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regression</td>
<td>18.341</td>
<td>1</td>
<td>18.341</td>
<td>15.142</td>
<td>0.014**</td>
</tr>
<tr>
<td>Residual</td>
<td>297.875</td>
<td>82</td>
<td>1.142</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>316.208</td>
<td>83</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a. Dependent Variable: Performance of MFIs
b. Predictors: (Constant), Competition

*p < .05

The regressions coefficient findings presented in Table 4.5 indicates that competition predicted the performance of MFIs (B = .256, p < .05). This means that one unit of increase in competition would lead to an increase in the performance of MFIs by a unit of 0.256. From the coefficients, the general form of the linear regression model equation that was established was as follows; Performance of MFIs = 1.534 + 0.256 Competition.

Table 4.5: Coefficient

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>T</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
<td></td>
</tr>
<tr>
<td>(Constant)</td>
<td>1.534</td>
<td>1.244</td>
<td>1.268</td>
<td>.000</td>
</tr>
<tr>
<td>Competition</td>
<td>.256</td>
<td>.078</td>
<td>.251</td>
<td>3.705</td>
</tr>
</tbody>
</table>

a. Dependent Variable: Performance of MFIs

*p < .05

4.4 Effect of Credit Management on the Financial Performance of Microfinance Institutions

This section sought to establish the relationship between credit management and the financial performance of MFIs from the respondents. Credit management was measured by six items namely; deliberate late payments, aggressive debt collection, credit rating system, credit risk
exposure, credit monitoring effectiveness and imposition of penalties. These items measured how credit management had affected performance in terms of profit margin, turnover, market share, and asset value in the respondents MFIs.

4.4.1 Descriptive Statistics for the Effect of Credit Management on the Performance of MFIs

Table 4.6 presents the frequency distribution of the respondents’ level of agreement or disagreement for the effect of credit management on the financial performance of their MFIs. The respondents were asked to answer the questions by indicating their opinion on given statements using a 5-point Likert scale of 1-5, where 1 = Very Low, 2 = Low, 3 = Moderate, 4 = High and 5 = Very High. The frequencies and percentages were computed, and the mean scores ranked. Effectiveness was denoted by mean scores of 3.5 and above ($M > 3.5$).

The results in Table 4.6 indicates that 52.9% of the respondents felt that late loan payments being perceived as cheap sources of funds relative to bank loans had a very high effect on the performance of profit margin in their MFI while 1.2% of the respondents felt that it had a low effect on performance ($M=3.71, SD=0.14$). The respondents who felt that lack of proper client credit rating had affected the performance of market share in their MFI moderately accounted for 5.8% while 34.1% of respondents agreed highly with the statement ($M=3.56, SD=0.10$). The respondents who felt that aggressive follow up and collection of overdue debts had a high effect on the performance of sales turnover in their MFI accounted for 51.7% while 3.5% of respondents felt it has a low effect ($M=3.65, SD=1.10$). The respondents who felt that imposition of charges/penalties for late payments had affected the performance of asset value in their MFI moderately accounted for 10.5% while 30.5% of respondents agreed highly with the statement ($M=3.58, SD=0.23$). The respondents who felt that lack of an efficient credit monitoring and debt collection system had a very high effect on the performance of sales turnover in their MFI accounted for 29.4% while 4.7% of respondents felt it had a very low effect ($M=3.77, SD=0.60$). The respondents who felt that credit risk exposure had a very high effect on the performance of profit margin in their MFI accounted for 25.8% while 5.8% of respondents felt it had a very low effect ($M=3.65, SD=0.86$).
### Table 4. 6: Descriptive Statistics for the Effect of Credit Management on the Financial Performance of MFIs

<table>
<thead>
<tr>
<th>Effect of Credit Management on the Financial Performance of Microfinance Institutions (MFIs)</th>
<th>%</th>
<th>f</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>Total</th>
<th>M</th>
<th>SD</th>
</tr>
</thead>
<tbody>
<tr>
<td>Late loan payments being perceived as cheap sources of funds relative to bank loans has affected the performance of profit margin of your MFI</td>
<td>%</td>
<td>1.2%</td>
<td>2.3%</td>
<td>5.8%</td>
<td>37.6%</td>
<td>52.9%</td>
<td>100%</td>
<td>.142</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>f</td>
<td>1</td>
<td>2</td>
<td>5</td>
<td>32</td>
<td>45</td>
<td>85</td>
<td>3.71</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Aggressive follow up and collection of overdue debts has affected the performance of turnover of your MFI</td>
<td>%</td>
<td>4.7%</td>
<td>3.5%</td>
<td>4.7%</td>
<td>51.7%</td>
<td>35.3%</td>
<td>100%</td>
<td>1.103</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>f</td>
<td>4</td>
<td>3</td>
<td>4</td>
<td>44</td>
<td>30</td>
<td>85</td>
<td>3.65</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lack of proper client credit rating has affected the performance of market share of your MFI</td>
<td>%</td>
<td>5.8%</td>
<td>4.7%</td>
<td>5.8%</td>
<td>34.1%</td>
<td>49%</td>
<td>100%</td>
<td>.101</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>f</td>
<td>5</td>
<td>4</td>
<td>5</td>
<td>29</td>
<td>42</td>
<td>85</td>
<td>3.56</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Imposition of charges/penalties for late payments to clients has affected the performance of asset value of your MFI</td>
<td>%</td>
<td>8.2%</td>
<td>5.8%</td>
<td>10.5%</td>
<td>30.5%</td>
<td>44.7%</td>
<td>100%</td>
<td>.236</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>f</td>
<td>7</td>
<td>5</td>
<td>9</td>
<td>26</td>
<td>38</td>
<td>85</td>
<td>3.58</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lack of an efficient credit monitoring and debt collection system has affected the performance of turnover of your MFI</td>
<td>%</td>
<td>4.7%</td>
<td>11.7%</td>
<td>7%</td>
<td>47%</td>
<td>29.4%</td>
<td>100%</td>
<td>.604</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>f</td>
<td>4</td>
<td>10</td>
<td>26</td>
<td>40</td>
<td>25</td>
<td>85</td>
<td>3.77</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Credit risk exposure has affected the performance of profit margin of your MFI</td>
<td>%</td>
<td>5.8%</td>
<td>8.2%</td>
<td>10.5%</td>
<td>48.2%</td>
<td>25.8%</td>
<td>100%</td>
<td>.865</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>f</td>
<td>5</td>
<td>7</td>
<td>9</td>
<td>41</td>
<td>22</td>
<td>85</td>
<td>3.65</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### 4.4.2 Correlation between Credit Management and the Performance of MFIs

Pearson Correlation test was used to test the relationship between credit management and the performance of MFIs. The results in Table 4.7 indicates that there was a statistically significant strong positive correlation between credit management and the performance of MFIs, $r(85) = .68$, $p < .05$. 

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Table 4.7: Correlation between Credit Management and the Performance of MFIs

<table>
<thead>
<tr>
<th>Variables</th>
<th>Credit Management</th>
</tr>
</thead>
<tbody>
<tr>
<td>Performance of MFIs</td>
<td>Pearson Correlation</td>
</tr>
<tr>
<td></td>
<td>Sig. (2-tailed)</td>
</tr>
<tr>
<td></td>
<td>N</td>
</tr>
<tr>
<td>Credit Management</td>
<td>Pearson Correlation</td>
</tr>
<tr>
<td></td>
<td>Sig. (2-tailed)</td>
</tr>
<tr>
<td></td>
<td>N</td>
</tr>
</tbody>
</table>

*.Correlation is significant at the 0.05 level (2-tailed).

4.4.3 Regression analysis between Credit Management and the Performance of MFIs

A simple linear regression was conducted to establish the extent to which credit management had an effect on the performance of MFIs. The findings of the model summary presented in Table 4.8 indicates that credit management explained about 61.4% of the variability in the performance of MFIs ($R^2 = .614$, $F(1, 82) = 7.54$, $p < .05$) and the strength of the relationship ($r = .706$).

Table 4.8: Model Summary

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>.706a</td>
<td>0.614</td>
<td>0.032</td>
<td>1.24513</td>
</tr>
</tbody>
</table>

a. Predictors: (Constant), Credit Management

*p < .05

The linear regression ANOVA results presented in Table 4.9 indicates that credit management statistically significantly predicted the performance of MFIs $F(1, 82) = 7.54$, $p < .05$. 
Table 4. 9: ANOVA

<table>
<thead>
<tr>
<th>Model</th>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regression</td>
<td>3.509</td>
<td>1</td>
<td>3.509</td>
<td>7.544</td>
<td>0.044b*</td>
</tr>
<tr>
<td>Residual</td>
<td>107.689</td>
<td>82</td>
<td>0.411</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>101.234</td>
<td>83</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a. Dependent Variable: Performance of MFIs

b. Predictors: (Constant), Credit Management

*p < .05

The regressions coefficient findings presented in Table 4.10 indicates that credit management predicted the performance of MFIs ($B = .423, p < .05$). This means that one unit of increase in credit management would lead to an increase in the performance of MFIs by a unit of 0.423. From the coefficients, the general form of the linear regression model equation that was established was as follows; Performance of MFIs = 1.644 + 0.423 Credit management.

Table 4. 10: Coefficient

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>T</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
<td></td>
</tr>
<tr>
<td>(Constant)</td>
<td>1.654</td>
<td>1.235</td>
<td>.367</td>
<td>1.248</td>
</tr>
<tr>
<td>Credit Management</td>
<td>.423</td>
<td>.085</td>
<td>.367</td>
<td>4.353</td>
</tr>
</tbody>
</table>

a. Dependent Variable: Performance of MFIs

*p < .05

4.5 Effect of Regulation on the Financial Performance of Microfinance Institutions

This section sought to establish the relationship between regulation and the financial performance of MFIs from the respondents. Regulation was measured by six items namely; Lack of regulations and policies on business registration, lack of regulations and policies on labor and minimum wages, stringent reporting requirements, lack of regulations and policies
on collateral requirements, high licensing costs and procedures and lastly, lack of administrative regulations on interest rates. These items measured how regulation had affected performance in terms of profit margin, turnover, market share, and asset value in the respondents MFIs.

4.5.1 Descriptive Statistics for the Effect of Regulation on the Performance of MFIs

Table 4.11 presents the frequency distribution of the respondents’ level of agreement or disagreement for the effect of regulation on the financial performance of their MFIs. The respondents were asked to answer the questions by indicating their opinion on given statements using a 5-point Likert scale of 1-5, where 1 = Very Low, 2 = Low, 3 = Moderate, 4 = High and 5 = Very High. The frequencies and percentages were computed, and the mean scores ranked. Effectiveness was denoted by mean scores of 3.5 and above ($M > 3.5$).

The results in Table 4.11 indicates that 43.5% of the respondents felt that lack of regulations and policies on collateral requirements had a very high effect on the performance of asset value in their MFI while 8.2% of the respondents felt that it had a low effect on performance ($M= 4.49, SD= 0.27$). The respondents who felt that high licensing costs and procedures had affected the performance of market share in their MFI moderately accounted for 11.7% while 47% of respondents agreed highly with the statement ($M= 4.35, SD= 0.16$). The respondents who felt that lack of regulations and policies on business registration had a high effect on the performance of profit margin in their MFI accounted for 38.8% while 4.7% of respondents felt it had a low effect ($M= 4.42, SD= 0.05$). The respondents who felt that lack of social regulations and policies on labor and minimum wages had affected the performance of number of employees in their MFI moderately accounted for 4.7% while 51.7% of respondents agreed highly with the statement ($M= 4.71, SD= 0.00$). The respondents who felt that stringent reporting requirements had a very high effect on the performance of market share in their MFI accounted for 49% while 5.8% of respondents felt it had a very low effect ($M= 4.20, SD= 0.10$). The respondents who felt that lack of administrative regulations on interest rates had a very high effect on the performance of profit margin in their MFI accounted for 48.2% while 4.7% of respondents felt it had a very low effect ($M= 4.54, SD= 0.01$).
Table 4. 11: Descriptive Statistics for the Effect of Regulation on the Financial Performance of MFIs

<table>
<thead>
<tr>
<th>Effect of Regulation on the Financial Performance of Microfinance Institutions (MFIs)</th>
<th>%f</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>Total</th>
<th>M</th>
<th>SD</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lack of regulations and policies on business registration has affected the profit margin of your MFI</td>
<td>%</td>
<td>2.3%</td>
<td>4.7%</td>
<td>2.3%</td>
<td>38.8%</td>
<td>51.7%</td>
<td>100%</td>
<td>4.42</td>
<td>.056</td>
</tr>
<tr>
<td></td>
<td>F</td>
<td>2</td>
<td>4</td>
<td>2</td>
<td>33</td>
<td>44</td>
<td>85</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lack of social regulations and policies on labor and minimum wages has affected the number of employees of your MFI</td>
<td>%</td>
<td>4.7%</td>
<td>3.5%</td>
<td>4.7%</td>
<td>51.7%</td>
<td>35.3%</td>
<td>100%</td>
<td>4.71</td>
<td>.006</td>
</tr>
<tr>
<td></td>
<td>F</td>
<td>4</td>
<td>3</td>
<td>4</td>
<td>44</td>
<td>30</td>
<td>85</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Stringent reporting requirements has affected the performance of market share of your MFI</td>
<td>%</td>
<td>5.8%</td>
<td>4.7%</td>
<td>7.1%</td>
<td>32.9%</td>
<td>49%</td>
<td>100%</td>
<td>4.20</td>
<td>.101</td>
</tr>
<tr>
<td></td>
<td>f</td>
<td>5</td>
<td>4</td>
<td>6</td>
<td>28</td>
<td>42</td>
<td>85</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lack of regulations and policies on collateral requirements has affected the performance of asset value of your MFI</td>
<td>%</td>
<td>8.2%</td>
<td>5.8%</td>
<td>10.5%</td>
<td>31.8%</td>
<td>43.5%</td>
<td>100%</td>
<td>4.49</td>
<td>.270</td>
</tr>
<tr>
<td></td>
<td>f</td>
<td>7</td>
<td>5</td>
<td>9</td>
<td>27</td>
<td>37</td>
<td>85</td>
<td></td>
<td></td>
</tr>
<tr>
<td>High licensing costs and procedures has affected the performance of turnover of your MFI</td>
<td>%</td>
<td>4.7%</td>
<td>7%</td>
<td>11.7%</td>
<td>47%</td>
<td>29.4%</td>
<td>100%</td>
<td>4.35</td>
<td>.162</td>
</tr>
<tr>
<td></td>
<td>f</td>
<td>4</td>
<td>26</td>
<td>10</td>
<td>40</td>
<td>25</td>
<td>85</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lack of administrative regulations on interest rates has affected the performance of profit margin of your MFI</td>
<td>%</td>
<td>4.7%</td>
<td>9.4%</td>
<td>10.5%</td>
<td>25.8%</td>
<td>48.2%</td>
<td>100%</td>
<td>4.54</td>
<td>.012</td>
</tr>
<tr>
<td></td>
<td>f</td>
<td>4</td>
<td>8</td>
<td>9</td>
<td>22</td>
<td>41</td>
<td>85</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

4.5.2 Correlation between Regulation and the Performance of MFIs

Pearson Correlation test was used to test the relationship between regulation and the performance of MFIs. The results in Table 4.12 indicates that there was a statistically significant strong positive correlation between regulation and the performance of MFIs, $r$ (85) = .71, $p < .05$. 

Table 4. 12: Correlation between Regulation and the Performance of MFIs

<table>
<thead>
<tr>
<th>Variables</th>
<th>Credit Management</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Performance of MFIs</td>
<td>Pearson Correlation</td>
</tr>
<tr>
<td></td>
<td>Sig. (2-tailed)</td>
</tr>
<tr>
<td></td>
<td>N</td>
</tr>
<tr>
<td>2 Regulation</td>
<td>Pearson Correlation</td>
</tr>
<tr>
<td></td>
<td>Sig. (2-tailed)</td>
</tr>
<tr>
<td></td>
<td>N</td>
</tr>
</tbody>
</table>

*. Correlation is significant at the 0.05 level (2-tailed).

4.5.3 Regression analysis between Credit Management and the Performance of MFIs

A simple linear regression was conducted to establish the extent to which regulation affected the performance of MFIs. The findings of the model summary presented in Table 4.13 indicates that regulation explained about 86.1% of the variability in the performance of MFIs ($R^2 = .861$, $F(1, 82) = 3.90, p < .05$) and the strength of the relationship ($r = .686$).

Table 4. 13: Model Summary

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>.686a</td>
<td>0.861</td>
<td>0.033</td>
<td>1.01258</td>
</tr>
</tbody>
</table>

a. Predictors: (Constant), Regulation

*p < .05

The linear regression ANOVA results presented in Table 4.14 indicates that regulation statistically significantly predicted the performance of MFIs $F(1, 82) = 3.90, p < .05$. 

50
Table 4.14: ANOVA

<table>
<thead>
<tr>
<th>Model</th>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regression</td>
<td>3.611</td>
<td>1</td>
<td>3.611</td>
<td>3.902</td>
<td>0.042</td>
</tr>
<tr>
<td>Residual</td>
<td>255.336</td>
<td>82</td>
<td>1.822</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>258.947</td>
<td>83</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a. Dependent Variable: Performance of MFIs
b. Predictors: (Constant), Regulation

*p < .05

The regressions coefficient findings presented in Table 4.15 indicates that regulation predicted the performance of MFIs ($B = .455, p < .05$). This means that one unit of increase in regulation would lead to an increase in the performance of MFIs by a unit of 0.455. From the coefficients, the general form of the linear regression model equation that was established was as follows:

$\text{Performance of MFIs} = 1.613 + 0.455 \text{Regulation}$.

Table 4.15: Coefficient

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>T</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Constant)</td>
<td>1.613</td>
<td>1.244</td>
<td>1.228</td>
<td>.000</td>
</tr>
<tr>
<td>Access to Finance</td>
<td>.455</td>
<td>.102</td>
<td>.265</td>
<td>4.672</td>
</tr>
</tbody>
</table>

a. Dependent Variable: Performance of MFIs

*p < .05

4.6 Chapter Summary

This section provides the summary of the major findings for each specific objective. The findings indicate that in terms of the effect of competition on the performance of MFIs, the proportion of male respondents who felt that competition had an effect on the performance of MFIs very highly accounted for 45.8% while female respondents accounted for 43.2%. The
results of the Pearson Correlation test indicated that there was a statistically significant positive correlation between competition and the performance of MFIs; \( r (85) = .76, p < .05 \). Linear regression results indicated that competition had a statistically significant effect on the performance of MFIs; \( B = 0.256, p < .05 \).

Concerning the effect of credit management on the performance of MFIs, the proportion of female respondents who felt that credit management affected the performance of MFIs moderately accounted for 16.2% while male respondents were 14.6%. Pearson Correlation test results showed that credit management was strongly correlated to the performance of MFIs; \( r(85) = .68, p < .05 \). The linear regression analysis showed that credit management explained 61.4% of the variability in the performance of MFIs, \( R^2 = .614 \) and statistically significantly had an effect on the performance of MFIs, \( F (1, 82) = 7.54, p < .05 \).

With respect to regulation and its effect on the performance of MFIs, the proportion of female respondents who felt that regulation affected the performance of MFIs highly accounted for 13.5% while that of male respondents was 10.4%. Pearson Correlation test indicated that regulation was significantly correlated to the performance of MFIs; \( r (85) = .71, p < .05 \). The findings of this study are discussed in the next chapter.
CHAPTER FIVE

5.0 SUMMARY, DISCUSSION, CONCLUSIONS AND RECOMMENDATION

5.1 Introduction

This chapter presents the summary of the study followed by detailed discussion of the results, conclusions and the recommendations of the study. The discussion of the results, conclusions, and recommendations for improvements are presented on the basis of the specific objectives of the study.

5.2 Summary of the Study

The purpose of this study was to determine the factors affecting the financial performance of Microfinance Institutions in Kinshasa, DRC. Three research questions have served as a guide to the study which included: What are the effects of competition on the financial performance of micro-finance institutions in Kinshasa, DRC? How does credit management affect the financial performance of microfinance institutions in Kinshasa, DRC? And lastly, what are the effects of regulations on the performance of microfinance institutions in Kinshasa, DRC?

A descriptive correlational research design was adopted by this study. The population comprised one hundred and thirty-five (135) credit officers of MFIs that had been operating in the last five years in Kinshasa at the time of the study. A stratified random sampling technique was used to select a sample of one hundred (100) credit officers of MFIs from the total population. The data collection instrument used in this study was a structured questionnaire. The study used descriptive and inferential statistics to analyze the data. The descriptive statistical analysis included frequencies and percentage distributions, mean and standard deviation while the inferential statistical analysis included Pearson Correlation and Regression analysis. Statistical Package for Social Sciences (SPSS) was used as a tool for statistical analysis and the results, and they were presented in figures and tables.

On the first research question regarding the effect of competition on the financial performance of MFIs, the male respondents who felt that competition affected the performance of MFIs
very highly accounted for 45.8% while that of female respondents accounted for 43.2%. Findings from Pearson Correlation test indicated that there was a statistically significant positive correlation between competition and the performance of MFIs; $r(85) = .76, p < .05$. Linear regression analysis indicated that competition explained 83.2% of the variability in the performance of MFIs, $R^2 = .832$ and statistically significantly predicted the performance of MFIs, $F(1, 82) = 15.14, p < .05$.

On the second research question concerning the effect of credit management on the financial performance of MFIs, the proportion of female respondents who felt that credit management affected the performance of MFIs highly accounted for 13.5% while male respondents were 14.6%. Pearson Correlation test results indicated that credit management was strongly correlated to the performance of MFIs; $r(85) = .71, p < .05$. The linear regression analysis revealed that credit management explained 61.4% of the variability in the performance of MFIs, $R^2 = 0.614$ and statistically significantly predicted the performance of MFIs, $F(1, 82) = 7.54, p < .05$.

Regarding the third research question, with respect to regulation and its effect on the performance of MFIs, the proportion of female respondents who felt that regulation affected the performance of MFIs slightly accounted for 13.5% while that of male respondents was 10.4%. Pearson Correlation test showed that regulation access was statistically significantly correlated to the performance of MFIs; $r(85) = .71, p < .05$. The linear regression analysis indicated that regulation explained 86.1% of the variability in the performance of MFIs, $R^2 = 0.861$ and statistically significantly predicted the performance of MFIs, $F(1, 82) = 3.90, p < .05$.

5.3 Discussion

5.3.1 Effect of Competition on the Financial Performance of Microfinance Institutions

The results revealed that 21.1% and 51.7% of the respondents moderately and very highly, felt that competition based on loan repayment by clients affected the performance of profit margin in their institution respectively. This finding agrees with a study by McIntosh and Wydick (2005) who acknowledged that increased competition might trigger an increase in loan supply in case new institutions enter the market. Loan supply further leads to multiple loan taking by
clients from different sources at the same time resulting in borrower over-indebtedness hence increased default rates by borrowers. As a result of lower levels of repayments and increased default rates, this adds to the costs of MFIs lending activities and affects its financial performance in the long run.

Pearson Correlation test showed that there was a statistically significant correlation between competition and the performance of MFIs at $r (85) = .76, p < .05$. The results confirmed the findings of a study by Motta (2004) which indicated that increased competition among MFIs is one of the outcomes following the increasing role of profit-oriented institutions and the change of status by NGOs from non-profit to profit-making (commercialized) institutions. Competition in the microfinance business is expected to be beneficial as it results in lower costs and interest rates, improved and new financial product designs, and better customer services.

Linear regression analysis showed that competition explained 83.2% of the variability in the performance of MFIs ($R^2 = 0.832$) and statistically significantly predicted the performance of MFIs ($B= .256, p < .05$). The findings agree with a study by McIntosh et al. (2005) which found that competition is measured at the lending group level in terms of the presence, number, and proximity of competitors providing group loans. It is assumed that the higher the number and presence of competitors and the smaller the distance to the nearest MFI, the stronger the competitive environment. On the other hand, in a more developed formal financial environment, the efficiency of MFIs improves due to competitive pressure (Hermes et al., 2009). The MFIs recognized the importance of building relationships through building a healthy personal relationship with clients to attract new clients and to enhance profitability and sales turnover.

The study further revealed that understanding the competition enables MFIs to identify segments of their customer base that might be at risk and to formulate a response. These findings were found to be consistent with the findings of Bauer and Colgan (2011) that activities concerning the competitive environment and organizations must remember to consider existing or potential competition from foreign as well as local organizations.

The study also revealed that to be successful MFI’s must do a better job than competitors on satisfying target consumers. This is what competitive advantage is about. Competitive
advantage therefore is about winning your target customers and retaining them. This is through coming up with a competitive strategy; in order for a business unit to come up with a competitive strategy it must first gain competitive edge from its rivals by securing the larger market share. The above findings concur with the research findings by Hubka and Zaidi (2005) that governments can help market-based microfinance by eliminating unfair competition from public institution, undertaking overall regulatory reform and improving the overall business environment.

5.3.2 Effect of Credit Management on the Performance of Microfinance Institutions

The findings revealed that 34.1% and 49% of the respondents felt that lack of proper client credit rating history had affected the performance of market share in their business and very highly respectively. This finding agrees with the study by Giacomo and Mattei (2009) that demonstrating due diligence at the loan application stage provides one of the most reliable data on the applicant's creditworthiness because history is the best predictor of the future. Keen awareness of the loan applicant concerning loan repayment would predict future behavior if granted credit.

Pearson Correlation test revealed that there was a statistically significant correlation between credit management and the performance of MFIs at $r(85) = .71, p < .05$. The result confirms study findings by Achou (2008) that better credit risk management results in better bank performance and it is thus of crucial importance for banks to practice prudent credit risk management to safeguard the asset of the bank and protect investors interest. Therefore, banks with robust credit risk management policies tend to incur lower loan default (impaired loans).

Linear regression analysis showed that credit management explained 61.4% of the variability in the performance of MFIs ($R^2 = 0.614$) and statistically significantly predicted the performance of MFIs ($B = .423, p < .05$). This was expected as lending officers often rely on personal judgment and experience to apply well-established lending principles, consistent with the views of Giacomo and Mattei (2009). A well trained and experienced authorizer will already have developed his or her heuristics to detect bad credit as opposed to a less experienced one.
According to studies by Achou (2008) who argue that, there is a significant relationship between financial institutions performance (in terms of profitability) and credit risk management (in terms of loan performance). The study states that better credit risk management results in better performance. Thus, it is of crucial importance that microfinance institutions practice prudent credit risk management and safeguarding the assets of the institutions and protect the investors’ interests. This is also true for microfinance institutions.

Another study by Mwangi (2012) argues that credit risk controls adopted by microfinance institutions have an effect on loan performance, credit insurance, diversification of loans, credit rating of customers, reports on financial conditions thereby affecting the overall performance of microfinance institutions. The study further argued that the involvement of credit officers and customers in formulating credit terms formulated by microfinance institutions had an effect on the performance of microfinance institutions.

According to study by Kitheka (2012) who similarly argues that the efficient management of credit management is a vital part of the overall risk management system and is crucial to each microfinance institution ‘s bottom and eventually the survival of all financial establishments. It is therefore important that credit decisions are made by sound analyses of risks involved to avoid harms to a microfinances’ profitability.

5.3.3 Effect of Regulation on the Performance of Microfinance Institutions

The results revealed that 47% and 29.4% of the respondents felt that high licensing costs and procedures have highly and very highly affected the performance of MFIs respectively. The findings are in line with a study by Rungani (2009) who found out that that small deposit taking MFIs without a license, operating in specific remote regions where there are no alternative savings services, should be allowed to continue. The local people would probably be improvished without such services (they already measure the risk of the institution against the risk of maintaining savings at home), the impact on the overall financial system is minimal, and excluding an MFI from certification, shows that the MFI does not correspond to specific criteria of the market.

Pearson Correlation test showed that there was a statistically significant positive correlation between regulation and the performance of MFIs at \( r (85) = .71, p < .05 \). This is consistent
with the findings by Bernanke (2008) that success of MFIs depends on the ability to disburse loans in order to spur performance profitability. The goal of regulation is to force micro lenders to internalize the losses on their assets, thereby mitigating moral hazard and protecting the deposit insurance fund.

Linear regression analysis showed that regulation explained 86.1% of the variability in the performance of MFIs \( R^2 = 0.861 \) and statistically significantly predicted the performance of MFIs \( B = .455, p < .05 \). CGAP (2000) argues that stating regulatory reviews specifically for MFIs may in certain cases lead to interest rate restrictions since normal banking regulations impose them on commercial banks. The usual problem with full licensing of MFIs to be able to accept deposits is that they are normally not eligible. In fact, most MFIs are not really in a position to even expect to become profitable, covering current operating costs, as well as administrative costs linked to deposits and other commercial funding.

Findings by Klein (2013) also revealed that microfinance institutions range from small charitable organizations operating in a limited geographical area to large institutions in several regions of the country. The regulatory framework for the financial sector in Kinshasa consists of various independent regulatory bodies each charged with the supervision of their various sub-sectors, the formal non-subsidized institutions include commercial banks, non-bank financial institutions, and savings and credit co-operative societies. The findings concur with the findings by Woodworth (2001) that governments must create a macroeconomic environment characterized by stable growth, low inflation, and fiscal discipline.

Minimum capital requirements specify the minimum absolute amount that owners must invest as equity in an institution seeking a license to accept deposits. Lower start-up cost lead to more MFIs entering a given market. Minimum capital requirements should be generally high enough to fund appropriate infrastructure and systems to cover start-up loses (Christen, 2012). The study continues to argue that a regulatory reform on stringent reporting requirements should facilitate the scaling up of the microfinance institutions and its integration with the formal financial sector. Particular attention should be paid to creating conditions conducive to commercialization of microfinance. For example, regulatory reforms that ensures that high interest rates will be tolerated by politicians and that regulators will consider the riskiness of loans rather than whether they are collateralized or not.
Shari (2015) argues that regulatory reform related to the microfinance sector should follow the fundamental tenant of prudential regulation on business registration policies. Deposit-taking institutions must be regulated while non-deposit-taking microfinance institutions can be left to the market for disciplining. In other words, the liability side of the balance sheet determines the need of regulation of microfinance institutions.

5.4 Conclusions

5.4.1 Effect of Competition on the Performance of Microfinance Institutions

Both correlation and regression analysis showed that there was a statistically significant positive relationship between competition and the performance of MFIs. Based on these findings, the study concludes that competition based on quality customer service, client relationship, cost reduction, number of branches, the proximity of competitors and loan repayment greatly affect the performance of MFIs in terms of profit margin, sales turnover, market share, and asset value while it is in operation.

5.4.2 Effect of Credit Management on the Performance of Microfinance Institutions

Both correlation and regression analysis showed that there was a statistically significant positive relationship between credit management and the performance of MFIs. In the MFI sector, it is difficult to separate borrowers and the lenders from the business. The credit management items that were investigated were deliberate late payments, aggressive debt collection, credit rating system, credit risk exposure, credit monitoring effectiveness and the imposition of penalties. Based on these findings, the study results to that credit management enables MFIs to perform dismally or exceptionally in terms of profit margin, sales turnover, market share, and asset value while the business is operational.
5.4.3 Effect of Regulation on the Performance of Microfinance Institutions

Both correlation and regression analysis revealed that there was a statistically significant positive relationship between regulation and the performance of MFIs in Kinshasa. A good number of MFIs are not aware of the regulatory authorities provided by the government to assist them to obtain licensing. Micro-financial institutions demand borrowers to provide collateral in order to reduce moral hazard; collateral creates a disincentive to the borrowers to acquire bank financing, and those poor borrowers are discriminated by banks due to high risks in lending to them. Therefore, the study concludes that regulation function plays a critical role towards the performance of MFIs growth of SMEs.

5.5 Recommendations

The following are recommendations for the factors affecting the performance of MFIs in Kinshasa.

5.5.1 Recommendations for Improvement

5.5.1.1 Effect of Competition on the Performance of Microfinance Institutions

From the study, it is quite clear that competition has a positive effect on the performance of MFIs. The study recommends that with increased competition, MFIs need to find ways of delivering services at lower costs to ensure them a competitive edge. In addition, MFIs need to establish strong client relationship through attracting poor people in the regions by giving them loans at much lower interests as well as conduct thorough vetting on their customers before advancing loans to them to ensure that they are creditworthy. This will enable the credit lenders to develop good judgment of their clients, to create a customer portfolio account that will help in assessing their clients' credit history.

5.5.1.2 Effect of Credit Management on the Performance of Microfinance Institutions

The study established that MFIs need to have authorizers with high competence level in terms of in training, skill, and experience in order to perceive an accurate judgment while rating the borrowers' creditworthiness. Thus, the study recommends that credit amount should be
carefully assessed for identified projects in order to ensure adequate funding. Any effort to improve financial access has to address the challenges related to access to collateral and capital. A way to guarantee the recovery of the money loaned is to impose some sort of collateral requirement on loan. It is a simple way of dealing with the aspect of securing depositors’ funds. It is thus, of crucial importance for banks to practice prudent credit risk management to safeguard the asset of the bank and protect investors’ interest.

5.5.1.3 Effect of Regulation on the Performance of Microfinance Institutions

The study findings showed that implementation of the regulations of MFI s to realize greater improvements in financial performance were hindered by lack of regulations and policies on business registration as well as high licensing costs and procedures. Therefore, the study recommends that for the microfinance institutions to perform better financially as well as survive in the market, they must conform to the rules and regulations regarding registration and adherence to the government policies. It also recommends the need for government to come up with policy reforms in business registration and licensing costs that will lead to better performance of microfinance institutions.

5.5.2 Recommendations for Further Studies

The study suggests that more research should be conducted to investigate the impact of government facilitation on financial market activities on the growth of MFI s in the Democratic Republic of Congo. The study also suggests that further research should be conducted to investigate the impact of access to credit information on the growth of MFI s in DRC other than Kinshasa.
References


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APPENDICES

Appendix I: Cover Letter

Andy Loko Tuema
United States International University - Africa
P.O. Box 14634 - 00800
Nairobi, Kenya

Dear Respondent,

RE: REQUEST FOR PARTICIPATION IN A RESEARCH STUDY

I am a Masters candidate in the Business Administration program at United States International University – Africa (USIU-A). I am conducting an Academic Research Project study titled; “Factors Affecting the Financial Performance of Microfinance Institutions in Kinshasa, Democratic Republic of Congo”, in partial fulfilment of the requirement for the Degree of Masters in Business Administration (MBA) at the university.

You have been identified as one of the respondents because of the expertise you present. In this regard, I kindly request that you spend some of your valuable time (10-15 minutes) to complete this questionnaire to the best of your knowledge. The response of the questions therein and all the information provided will be used purely for academic research. Your responses will be treated with the confidentiality it deserves.

Results of the study are vital to current and future Microfinance Institutions as well as small scale micro lenders. To maintain anonymity, I request that you DO NOT write your names on the questionnaire. Thank you in advance for accepting to be a positive contributor to our society. Attached is a copy of the introduction letter from the Associate Deputy Vice Chancellor Academics-Research at USIU-A which certifies that I’m a student in the mentioned program. In case you may want a copy of this project report, kindly reach me via my contacts below. Thank you.

Yours sincerely,
Appendix II: Questionnaire

SECTION 1: DEMOGRAPHIC INFORMATION

Kindly answer the following questions by providing a brief answer in spaces provided or ticking (√) in the boxes.

1. What is your gender?
   Male ( )  Female ( )

2. What is your age bracket?
   Below 25 years ( )
   25 – 29 years ( )
   30 - 34 years ( )
   35 - 39 years ( )
   40 years and above ( )

3. What is your highest level of education qualification?
   Post-graduate ( )
   Diploma/Certificate ( )
   Graduate ( )
   Primary/Secondary ( )

4. What is your department?
   Sales and Marketing ( )
   Finance and Back Office ( )
   Customer Service ( )

5. For how long have you been operating?
   Less than 1 year ( )
   4 to 5 years ( )
### SECTION 2: EFFECT OF COMPETITION ON THE PERFORMANCE OF MFIs

Kindly indicate by ticking (√) the extent to which competition has affected the performance of your MFI in the last 5 years. Use a scale of 1-5 where: where 1 = Very Low, 2 = Low, 3 = Moderate, 4 = High and 5 = Very High

<table>
<thead>
<tr>
<th>Effect of Competition on the Financial Performance of Microfinance Institutions (MFIs)</th>
<th>Very Low</th>
<th>Low</th>
<th>Moderate</th>
<th>High</th>
<th>Very High</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>(Performance Indicators: Profit Margin, Turnover, Market Share, Asset Value)</strong></td>
<td>(1)</td>
<td>(2)</td>
<td>(3)</td>
<td>(4)</td>
<td>(5)</td>
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<tr>
<td>6. Competition based on providing quality customer service has affected the performance of profit margin of your MFI</td>
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<td>7. Competition based on establishing strong client relationship has affected the performance of turnover of your MFI</td>
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<td>8. Competition based on cost reduction in providing loans has affected the performance of market share of your MFI</td>
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<tr>
<td>9. Competition based on number of branches providing loans has affected the performance of asset value of your MFI</td>
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<td>10. Competition based on proximity of competitors providing loans has affected the performance of turnover of your MFI</td>
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<tr>
<td>11. Competition based on loan repayment by customers has affected the performance of profit margin of your MFI</td>
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</tbody>
</table>
SECTION 3: EFFECT OF CREDIT MANAGEMENT ON THE PERFORMANCE OF MFIs

Kindly indicate by ticking (√) the extent to which Credit Management has affected the performance of your MFI in the last 5 years. Use a scale of 1-5 where: where 1 = Very Low, 2 = Low, 3 = Moderate, 4 = High and 5 = Very High

| Effect of Credit Management on the Financial Performance of Microfinance Institutions (MFIs) | Very Low | Low | Moderate | High | Very High |
| (Performance Indicators: Profit Margin, Turnover, Market Share, Asset Value) | (1) | (2) | (3) | (4) | (5) |
| 12. Late loan payments being perceived as cheap sources of funds relative to bank loans has affected the performance of profit margin of your MFI | | | | | |
| 13. Aggressive follow up and collection of overdue debts has affected the performance of turnover of your MFI | | | | | |
| 14. Lack of proper client credit rating history has affected the performance of market share of your MFI | | | | | |
| 15. Imposition of charges/penalties for late payments to clients has affected the performance of asset value of your MFI | | | | | |
| 16. Lack of an efficient credit monitoring and debt collection system has affected the performance of turnover of your MFI | | | | | |
| 17. Credit risk exposure has affected the performance of profit margin of your MFI | | | | | |
SECTION 4: EFFECT OF REGULATION ON THE PERFORMANCE OF MFIs

Kindly indicate by ticking (√) the extent to which Regulation has affected the performance of your MFI in the last 5 years. Use a scale of 1-5 where: where 1 = Very Low, 2 = Low, 3 = Moderate, 4 = High and 5 = Very High

<table>
<thead>
<tr>
<th>Effect of Regulation on the Financial Performance of Microfinance Institutions (MFIs) (Performance Indicators: Profit Margin, Turnover, Market Share, Asset Value,)</th>
<th>Very Low</th>
<th>Low</th>
<th>Moderate</th>
<th>High</th>
<th>Very High</th>
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<tr>
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<td>18. Lack of regulations and policies on business registration has affected the performance of profit margin of your MFI</td>
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<td>19. Lack of social regulations and policies on labor and minimum wages has affected the number of employees of your MFI</td>
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<td>20. Stringent reporting requirements has affected the performance of market share of your MFI</td>
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<td>21. Lack of regulations and policies on collateral requirements has affected the performance of asset value of your MFI</td>
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<td>22. High licensing costs and procedures has affected the performance of turnover of your MFI</td>
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<tr>
<td>23. Lack of administrative regulations on interest rates has affected the performance of profit margin of your MFI</td>
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</tbody>
</table>

‘THANK YOU’