Micro-Finance Institutions (MFIs): Assessing their performance through the lens of an entrepreneur

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Abstract

The study sought to find out the sources and access to funding for entrepreneurs, with the specific focus on micro-finance. A combination of qualitative and quantitative research methodologies was used. Interviews, based on a structured questionnaire were used to gather primary data from thirty (30) respondents. The study provided insights into the environment of credit granting, and into the dynamics of operating a microfinance business. The findings indicate that credit is made available in 100 percent of the cases where small business owners are involved, in 97 percent of the cases where informal traders are involved and in 60 percent of the cases involving emerging entrepreneurs. It also transpired that, the full amount of the loan applied for is advanced in 97 percent of the cases. In 80 percent of the cases, the literacy level of potential clients does not affect the turnaround of loan applications, because potential clients understand the criteria
for receiving a loan. The study recommends improving methods of communicating the availability of credit and creating partnerships with stakeholders.

**KEYWORDS:** Entrepreneurs, Finance, Performance

**Introduction**

The Small and Medium Enterprises (SMEs) sector is key to growing the South African economy. SMEs have a significant role to play as they contribute towards employment creation, poverty reduction and improvement in the standard of living. Entrepreneurs (especially the emerging), informal traders and small business owners require finance in order to develop and grow their businesses. Formal financial institutions often do not readily make funds available without loan security, collateral in the form of assets, steady employment and a verifiable credit history. Due to such barriers confronting entrepreneurs, alternative sources such as micro financing and community-based lending have been conceived.

The South African government (government) has been instrumental in promoting the SME sector through passing various items of legislation. The National Development Plan (NDP), amongst its objectives, aims to achieve a much higher rate of economic growth. Part of the core focus areas of the NDP is to develop the SMEs so that they can play a bigger role in creating employment.

**1.1. Problem statement**

Small and Medium Enterprises (SMEs) play a vital role in economic development as they have been the main source of employment generation and output growth, both in developing as well as in developed countries (Love and Roper, 2013 as cited in Ramukumba (2014: 19-20). For the past twenty two years, the South African Government has invested in several initiatives aimed at supporting and growing the SME sector. The government has been instrumental in initiating strategies to maintain and enhance SMEs development and sustainability. However, despite their significance and contribution to economic growth, SMEs across the world,
and in South Africa in particular, are still faced with numerous challenges that inhibit entrepreneurial growth (Mahembe, 2011:7). Amongst the reasons for the failure of both male and female-owned businesses is the non-availability of external finance (Gundry et al., 2002:69, cited in Garwe D.K and Fatoki O (2012:449).

Entrepreneurs need finance to start and sustain their businesses. However, formal finance institutions such as banks require, amongst others, projected management accounts and business plans, *albeit* requirements that cannot easily be met by small businesses, informal traders as well as emerging entrepreneurs. Reasons for banks to shy-away from early stage firms include, lack of a track record of reliable information on the part of entrepreneurs, start-ups being illiquid, too much debt outstanding, and volatility of profit and cash flow measures (Markova and Petkovska-Mircevska, 2009:602). Businesses often lack the collateral and financial records (e.g. audited financial statements) required for commercial loans (Ramukumba, 2014: 25). Stokes and Wilson (2006) cited in Ramukumba (2014: 25), also note that financial difficulties for SMEs arise, either because of inabilities to raise sufficient funds to properly capitalise the business, or mismanagement of the funds that do exist or a combination of both.

Despite the above generalisations, the issue of funding and access to finance for SMEs remains less understood in the South African context. Many SMEs rarely survive their fifth birthday in South Africa because of funding constraints, among other factors. The purpose of this paper is to provide some insights into the funding of SMEs in South Africa with a view to proffering recommendations on how they can best be funded to ensure their survival and sustainability.

**The objectives of the research study were:**

- To identify the role that micro-financiers play in promoting access to credit for entrepreneurs;
- To establish the level of demand for micro-finance by SMEs;
- To ascertain the challenges that micro-financiers face; and
- To assess the sustainability of the micro-finance business.

**Literature Review**

The literature review sought to understand the business of microfinance in general and to fulfil the objectives of the study in particular. The views of various authors and researchers on the topic were carefully studied and analysed. The majority noted that the subject of microfinance has not been fully exhausted and that a balance between poverty alleviation and sustainability and growth should be sought.

1.2. Entrepreneurship defined

The word ‘entrepreneur’ is derived from French, where the verb ‘entreprendre’ means ‘to undertake’. Entrepreneur is a term applied to the type of personality who is willing to take upon her/himself a new venture or enterprise and accepts full responsibility for the outcome (Markova and Petkovska, 2009:597). The word *entrepreneur* is often used synonymously with *founder*. Entrepreneurship is defined as the capacity and willingness to develop, organise and manage a new venture along with any of its risks in order to create a net value (Belkhir, 2015). Furthermore, entrepreneurship is the practice of starting new organizations or revitalizing mature organizations, particularly new businesses generally in response to identified opportunities (Markova and Petkovska, 2009: 597). Entrepreneurial start-up ventures create jobs, and sustain the economic growth Markova and Petkovska-Mircevska (2009:603). SMEs are considered the “lifeblood of modern economies” (Rao, Metts & Monge, 2003: 13), cited in Ramukumba (2014: 25).

Studies show that the economic growth of any country is closely linked to SME development Ramukumba (2014: 20). Studies done recently, sought to understand entrepreneurship in terms of the perception and the pursuit of opportunity. The
authors argue that entrepreneurs are unique in their ability to perceive and exploit opportunities that others would normally not recognise and overlook. The need for entrepreneurs could be considered to be the most important requirement for economic development in a country (O’Neill and Viljoen 2001).

At the heart of the entrepreneurial process is the creation and/or recognition of opportunities. The classic entrepreneurship is the ‘Start-Up’ company, where a raw idea develops into a high-growth company and the success involves a strong main entrepreneur and a team with complimentary talents (Markova and Petkovska, 2009: 598).

1.3. The purpose of microfinancing

It can be argued that MFIs are social entrepreneurs. Kickul and Lyons (2012:19) define a social entrepreneur as a social innovator, who adds value to people’s lives by pursuing a social mission using the processes, tools and techniques of business entrepreneurship. The profits generated by the enterprise are used to expand the reach of the mission (Kickul and Lyons, 2012:19). The mission of the case study (Moliko Finance Trust) is to empower the economically active poor in rural and suburban South Africa by providing high quality, client-responsive, appropriate and viable financial services; in order to increase its clients' livelihood options in an ethical and profitable manner.

Microfinance clients have absent access to formal financial services, however, that has not deterred them from developing a variety of informal, community-based financial arrangements to meet their needs (Brau and Woller 2004:2) and to use credit for any type of expenditure (Armendariz and Labie, 2011:54). The aim of the loan, being enterprise development, suggests that microfinancing aims to alleviate poverty through entrepreneurial initiatives (Khavul, 2010:57). Because microloans must be repaid, they should be offered to those engaged in income-generating activities (Ayayi and Yusupov, 2012:84).
Khavul (2010:60) explains that traditional financial institutions find serving the poor, risky and expensive, because the poor have limited collateral, no official credit histories, and are often dispersed across a rural area. Microfinance activities, on the other hand, are conducted in areas with a high percentage of low-income and often marginalised groups in suburban and to a lesser extent rural areas (Armendariz and Labie, 2011:301).

1.4. Microfinance Institutions (MFIs)

Modern development theories place eminence on the essential role of access to finance (Ojong, 2014:288). Microfinance has enjoyed growth since its inception in the late 1970s to becoming a dynamic sector that offers a variety of financial services over and above microcredit (Gueyie et al., 2013:4). Microfinance services across the globe, and more particularly in third world countries, have experienced explosive growth since the 1980s, as the inhabitants and the financial institutions of developing countries have discovered the potential of microfinance to alleviate poverty among the marginalised population groups, especially the non-whites and females in rural areas (Timberg & Aiyar, 1984; Chipeta & Mkandawire, 1992; Tshaka, 2002) cited in Siyongwana (2004: 581). Microfinance has received a lot of attention as an important instrument to combat poverty. The United Nations declared 2005 as the International Year of Microcredit and in 2006 microfinance and its role in reducing poverty was highlighted when Mohammad Yunus received the Nobel Peace prize (Armendariz and Labie, 2011:174). The microfinance industry consists of credit, savings and insurance institutions Daniels (2004: 831).

Microfinance was founded to provide finance to the marginalised communities, which the formal institutions find risky to serve. According to Zeller and Meyer (2002:1) the founders of microfinance in Bangladesh, Bolivia and Indonesia shared a vision of supplying formal financial services to poor people shunned by banks because their savings were tiny, their loan demand was small, and they lacked loan collateral. Mathebula (2013:4) explains that microcredit makes credit available to the unemployed entrepreneurs, who are considered ‘unbankable’ because they
lack collateral, steady or permanent employment, income and verifiable credit histories and, in most instances, they do not meet the minimum requirements of the mainstream formal sector-financial institutions. Kodongo and Kendi (2013:99) add that these borrowers are high-risk individuals since they have typically low net-worth with little or no collateral or saleable assets that can be acquired by the MFI in the event of a default.

According to Gueyie, Manos and Yaron (2013:68) the MFIs themselves appear to prefer simple and relatively inexpensive methodologies based on individual interviews or focus group discussions to help better understand the interaction between clients and products and services. Certain microfinance institutions (MFIs) focus on maximizing profits, and do so while lending to the poor, whereas others seek to maximize access for the poor subject to a budget constraints (Karlan and Zinman, 2008: 1040). Three basic models of liability employed by MFIs are: solidarity groups; village banking; and individual lending (Armendariz and Labie, 2011:23). These are the methodologies used by MFI:

**Solidarity groups:** This is the classic microfinance model, often referred to as the ‘Grameen model’ after the pioneering Grameen Bank in Bangladesh. It involves 5-person solidarity groups, in which each group member guarantees the other member’s repayment (Armendariz and Labie, 2011:23).

**Village banking:** expands the solidarity group concept to a larger group of, say, 15-30 people who are responsible for managing the loan provided by the MFI as well as for making and collecting loans to and from each other (Armendariz and Labie, 2011:23). Members typically make a savings contribution to a central pool, from which other members can take loans (Basu, 2013:37). As members often live in villages that are scattered and therefore make formal banking almost impossible, village banks, act as financial intermediaries in areas where the banking network is not satisfactory (Lazar, Natarajan and Deo, 2010:19).
Individual lending: this type of lending is made available to clients who are not dependent on some form of group support system but who can provide collateral or substitute funding. The provision of financial services to individuals instead of groups has a similar format as traditional banking, in that collateral or collateral substitutes may be required from borrowers (Armendariz and Labie, 2011:23). Banarjee (2013:493) states that individual loans are substantially larger and are much more likely to be collateralized. Although group loans make up the bulk of microloans worldwide, individual lending is significant in some areas (Eastern Europe, Russia, and China) and is growing in popularity (Brau and Woller, 2004:10).

1.5. The role of microfinance in promoting access to credit

MFIs work towards a double bottom-line, being financial and social, unlike the typical formal financial institution which works solely towards a financial bottom-line (Brau and Woller, 2004:14). Gueyie et al. (2013:3) explain that access to credit can help the poor accumulate fixed assets, tools and equipment that can enhance income-generation ability and employability, and can lead to better education, improved housing or better health care. Armendariz and Labie (2011:173-174) explain that MFIs provide loans to borrowers who have no or very limited access to other sources of finance, allowing small-scale entrepreneurs to generate a stable and possibly, even a growing income. Armendariz and Labie (2011:326) argue that microfinance provides access to financial means, supporting people who want to help themselves by taking initiatives to secure a better life as they attempt to leave poverty behind. Many MFIs seek to expand access and often target specific groups, such as, female and relatively poor borrowers (Karlan and Zinman, 2008: 1059).

Social performance is assessed by the breadth of outreach, the indicators being the number of customers and the size of the loan (Armendariz and Labie, 2011:403; Ayayi and Yusupov, 2012:90). The higher the number of customers, the higher the breadth of the outreach (Armendariz and Labie, 2011:403). The objective of maximizing outreach is measured by the number of individuals gaining access to
microcredit (Ayayi and Yusupov, 2012:90). The idea that outreach equals poverty reduction is based on the assumption that access to credit results in higher income, which in turn creates the ability to handle increased amounts of credit, and this spirals into a positive cycle of credit (Haase, 2013:29). As long as the loans are repaid, this must mean that the clients have increased their repayment capacity, and consequently their income (Haase, 2013:29).

1.6. Sustainability of the microfinance business

According to Gueyie et al., (2013:6) a large proportion of microfinance research deals with questions of performance and impact. This focus on performance could be due to a lack of financial sustainability in the MFIs (Gueyie et al., 2013:6). Performance-related research addresses issues such as what performance indicators should be used, the balance between social and financial performance and the search for key determinants of MFI performance (Gueyie et al., 2013:7). Impact-related research focuses on evaluating the impact of the microfinance intervention on the target clientele, on aspects such as the empowerment of women, housing or recovery following natural disasters (Gueyie et al., 2013:7). An increasing number of formal sector organisations (non-government, government, and private) have been created for the purpose of meeting the same needs, that of poverty alleviation (Brau and Woller, 2004:2). This argument tends to support the fact that MFIs are not profitable entities, mostly meeting a social need. Brau and Woller (2004:3) argue that unlike the formal sector financial institutions, the large majority of MFIs are not sustainable; instead, most MFIs are able to operate without covering their costs due to subsidies and gifts from governments and other donors.

According to Hernes and Lensink (2009:878) only 1–2 percent of all MFIs in the world (i.e., some 150 organisations) are financially sustainable. In most incidences, these are larger, mature, regulated, and relatively well-known MFIs (Hernes and Lensink, 2009:878). Some 8 percent of all MFIs are close to being profitable, these groups of MFIs are considered to be commercial organisations, focusing on profitability and/or sustainability (Hernes and Lensink, 2009:878). A third group of
organisations (20 percent of all MFIs) consist mostly of NGOs, which are not yet financially sustainable, but may become sustainable in the near future (Hernes and Lensink, 2009:878). The remaining group of MFIs (70 percent of all organisations) consist of smaller, start-up organisations, which are still far from being financially sustainable and are, therefore, heavily dependent on subsidies (Hernes and Lensink, 2009:878).

The move to sustainability – also known as the institutionalist approach is based on the argument that ‘to contribute to sustainable poverty reduction, MFIs themselves must be viable, sustainable, and growing [since] microfinance is a business, not charity’ (IFAD, 2001, p. 5) cited in (de Haan and Lakwo (2010:531). Factors that contribute to a sustainable microfinance business are as follows:

**Number of MFI clientele:** In the credit market space such as a banking environment more customers translate to more loans given and a higher return for the institution. With microfinancing having more customers frequently means higher acquisition and servicing costs as villages are further away from the MFI’s branches to be targeted (Basu, 2013:112). According to Basu (2013:112), rural clients living in villages require loan officers to travel to them in order to register loans and make payments which is costly. If more customers are taken in, Basu (2013:112) explains that client businesses located away from MFIs mean less monitoring and site visits by loan officers, and these client businesses will experience low performance which will arguably affect their profit margins. If the client is not performing well, it can affect the pace of repaying the loan which will mean less cash flow for MFIs. Basu (2013:112) argues that more customers mean that the loan officers need to acquire a diversified skill-set to meet the needs of their customer base, making focusing and client care a challenge and this can result in bad debts, which will have an immediate negative effect on MFIs’ profitability. According to Armendariz and Labie (2011:403) the number of customers is taken as an indicator of the breadth of outreach; the higher the number of customers, the higher the breadth of outreach. Centre meetings are the backbone of MFIs, bringing
clients together wherein repayments are made and any client issues can be addressed.

**Efficiency of the institution:** Basu (2013:112) explains that a number of factors determine the efficiency of an MFI. These are: type of clients, the cost of providing automation and reliable systems. The client base has already been discussed; the other two factors, source of funding and the management information system, fall outside the scope of this study and will therefore not be discussed. However, they can form part of findings and recommendations for further research study.

Brau and Woller (2004:4) concluded that institutional sustainability was key to successful provision of financial services to the poor and financial self-sufficiency was a necessary condition for institutional sustainability. MFIs can achieve sustainability without achieving financial self-sufficiency (Brau and Woller, 2004:4). Donors can be viewed as social investors, who do not expect to earn monetary returns but realise a social/intrinsic return (Brau and Woller, 2004:4). According to Brau and Woller (2004:5) limited evidence leads many to conclude that if financial self-sufficiency is desired, then the very poor will not be reached by MFI services; that is, the MFI will not be able to achieve enough depth to reach those who need credit the most desperately.

**The provision of ‘microfinance plus’:** According to Basu (2013:113-114) many MFIs pride themselves in providing a number of services to their customers from education sessions that cover financial literacy and marketing support, to female empowerment. Basu (2013:114) argues that while these services may add value, they come at a cost to the MFI. If grants from donors do not cover such costs, they can sometimes be added to interest rates and therefore off-loaded onto borrowers (Basu, 2013:114). Brau and Woller (2004:8) explain that MFIs integrate microfinance with other non-financial services, usually education. The authors conclude that business development training significantly improves microenterprise performance and micro entrepreneur empowerment. According to Armendariz
and Labie (2100:24) MFIs have begun to offer a variety of services such as insurance, skills training and remittance services.

Social responsibility Social responsibility, in microfinance, is defined as available financial services that effectively and efficiently meet the different needs of the different categories of the population at a price that is compatible with their ability to afford it, and in forms that are culturally accessible (Armendariz and Labie, 2011:311). Basu (2013:114) argues that these principles rely on self-regulation by MFIs and do not seem to have been fully implemented, nor enforced by respective regulators. In addition, social performance should aim to measure client satisfaction, measure changes in the well-being of clients and provide a humane working environment and measure staff satisfaction (Basu, 2013:114). According to Basu (2013:115) if properly implemented, these factors will result in better-run MFIs resulting in a sustainable and more profitable business and better investment. Armendariz and Labie (2011:402) explain that although MFIs carry out some of the functions that traditional banking institutions perform, their social work makes them different.

Methodology

Qualitative research is concerned with qualities and non-numerical characteristics, while quantitative data is all data that is collected in numerical form (Hussey and Hussey, 1997:150). A quantitative approach is predominantly used as a synonym for any data collection technique (such as a questionnaire) or data analysis procedure (such as graphs or statistics) that generates or uses numerical data (Saunders et al., 2012:161). Both qualitative and quantitative methods of collecting data were used. This aim was to get an in-depth understanding of the performance of microfinances and also strengthen analysis by ensuring that the limitations of the data collected from one method of data are balanced by the strengths of another.
In this research study, thirty (30) respondents participated. The study used questionnaires as well as semi-structured interviews to collect primary data. It involved the collection and analysis of numerical data such as size of the loan that can be quantified to help answer the research questions.

Results and Discussion

The findings show that, credit is made available in 100 percent of the cases involving small business owners, in 97 percent of the cases involving informal traders and in 60 percent of the cases involving emerging entrepreneurs. The targeted clients are self-employed in poor marginalized communities of QwaQwa and Botshabelo in the Free State, Matatiele in the Eastern Cape and Newcastle and Vryheid in KwaZulu-Natal.

The availability of credit is advertised, the method of communication being word of mouth for 97 percent of the time and 3 percent can be attributed to the use of print and electronic media. The field officers get specifically tasked to travel through the villages and townships and to identify a need for uplifting the community. They then initiate pre-screening, group formation and articulate the process of loan approval.

The full amount of the loan applied for is advanced in 97 percent of the cases. It is then distributed to each member of the group. The group consists of 5 to 7 people, each one pursues their own venture. The group members are encouraged to diversify their business interests in order “to avoid cluttering a popular yet saturated market”. The group members still work together to leverage their own resources through bulk buying from wholesalers and by taking business advice. Members are encouraged to use a part of their income to save, they each have a savings book through the local Post Office branch.

The repayment periods vary from 4 months to 12 months and the frequency is as follows: 4 months – 67 percent; 6 months – 100 percent; 9 months – 90 percent and 12 months -64 percent. The initial amount advanced is a small short-term loan, once
business evaluation has been performed and repayments are made satisfactorily, subsequent loans are increased based on the performance of the enterprise. Incremental housing loans to extend the house or make home improvements, are made to qualifying individuals and are advanced for a medium term period.

In 73 percent of the cases repeat loans are made upon full repayment of the loan; in 97 percent of the cases repeat loans are made during the tenure of the existing loans. Repeat loans are an indication of the demand for credit once a client has proven that he/she is able to make regular payments. 100 percent of business loan applicants (potential clients) understand and meet the criteria for receiving funding. The partnership between Moliko Finance Trust (the Trust) and potential clients begins at an early stage, where a 3-day training programme on basic business skills is offered. The criteria for approval of business loan applications has been stable over time and through community engagements prospective clients become familiar with the process. With incremental housing loans, the criteria has been tightened so that credit checks are performed as well as requiring collateral from individual applicants.

The respondents were neutral with regard to the approval process for informal traders, being different from that of other clients. The Trust’s focus is on applying the principles of group-lending methodology, irrespective of the type of business formed. Because of face-to-face engagements, even semi-literate potential clients are able to understand the process of loan application and approval, group association is a strong advantage for this category of potential clients.

In 80 percent of the cases, the literacy level of potential clients does not affect the turnaround of loan applications, because potential clients understand the criteria for receiving a loan. This can be attributed to a simple loan process structure and proper targeting of business-savvy individuals. Site visits are conducted by field workers in 100 percent of the cases, to provide business support and proactively to analyse and identify challenges within the business setup. 100 percent of the respondents agree that the Trust has proper mechanisms to monitor proper usage
of funds. The loans have to be repaid, it is therefore important that clients engage in income generating activities.

In 97 percent of the cases, the Trust makes interventions where client businesses show signs of distress or of making a loss. Group members are encouraged to diversify their businesses, seek new opportunities and regularly attend centre meetings where a variety of topics that affect their business environment, are discussed. 97 percent of the respondents agree that provincial or national government can do more to support businesses and prevent failure thereof. The services offered to Small and Medium Enterprises (SME) should be able to reach remote areas, as this is the mandate of the Ministry of Small Business Development.

**Conclusion and Recommendations**

**Conclusion**

The study findings from the secondary data and primary research complement each other, emphasis being placed on fieldwork which is key to ensuring success of client businesses, and in turn contributes to the sustainability of the microfinance enterprise. There are systems in place for effective monitoring and control, although a gap seems to exist in profiling the MFIs, so that all relevant stakeholders such as potential funders and policymakers can make a positive contribution to achieving the long-term vision of the MFIs.

In order to enhance entrepreneurs’ access to funding sources, the following recommendations are in order:

**Enhance the marketing and communication of credit availability**

- MFIs should explore other platforms of communicating availability of credit such as print and electronic media. With the dawn of technological advances, the internet and social media platforms could elevate the profile of the MFIs.
Affiliation with industry associations

- Affiliation to industry associations will enable the MFIs to keep abreast with developments in the industry and to obtain specialised skills and services that an organisation would normally not be able to afford. Industry affiliation also encourages peer review, wherein organisations in the industry are able to evaluate themselves by measuring their performance and improve quality. Peer review is a form of self-regulation, the members police one another and that can include ranking by independent experts in the field as a form of enhancing credibility. Issues such as governance and regulatory compliance are key to a sustainable and profitable business.

Creating partnerships with stakeholders

- Outreach into the rural community which is sparsely populated and widely dispersed is key. This community can be reached through mobile offices where a one stop shop should be created consisting of a banking institution to facilitate savings, an information centre providing information on local government services that SMEs require to enhance their operations and microfinance services. Government contacts are established by registering on relevant databases, in accordance with procurement regulations and this information should be distributed through such mobile offices.
References


