

FACTORS INFLUENCE THE GROWTH AND PENETRATION OF MICROFINANCE INSTITUTIONS: A CASE OF EGYPT

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ABSTRACT

Microfinance Institutions (MFIs) offers small loans with easy repayment system and till now these institutions have served millions of needy people around the globe. This study highlights the hurdles influence the smooth working and growth of Microfinance institution in Egypt. The structured interviews were conducted from the top and mid-level managers of MFI's. This study revealed that interest rate, political and economic conditions, corruption, customer outreach, competition and technology are the important elements for MFI's success. It is evident that lack of use of technology and less importance drawn on customer outreach programs are the main challenges of MFI's in Egypt. This study provides a roadmap for practitioners and strategic policymakers to consider these factors while making policy either at the institutional level or country level.

Keywords: Microfinance Institutions, Interest Rate, Corruption, Structured Interviews.

INTRODUCTION

The idea of Microfinance was first coming into light during the times of 1950-1980, with the reason for mitigating destitution by providing small advances to poor farmers. The pioneers of the Microfinance were the associations, for example, the Grameen Bank in Bangladesh, Self Employed Women's Association (SEWA) Bank in India and ACCION International in Latin America (Banerjee, Duflo, Glennester & Kinnan, 2013). Ideally, the concept of microfinance was to fund all the poor and deprived people around the globe where they cannot approach formal credit (Saraf, 2015). The scheme of microfinance is to provide small loans with other services like entrepreneurship guidance, insurance, etc., (Fisher & Sriram, 2002). Whereas, microcredit is an integral part of microfinance which only focuses on credit financing. The impact of microfinance on poverty alleviation is in debate since the emergence of this concept. The methodology to measure the impact of microfinance on poverty has been in debate. It just concentrates on change of income as a measure of effect on destitution is one of the prominent weaknesses as expanding income level and decreasing poverty has critical distinction. Ledgerwood (1999) contended that increase in income level of creditor depends on spending of this income, so the concentration ought to be to support the creditors by giving an assortment of financial services.

The focus of microfinance to empower women in lower-income households has been underpinned in previous literature. The extent of previous literature focused to study the effect of microfinance on women decision making power. Cheston & Kuhn (2002) found a positive

impact of microfinance on women decision making in a study conducted in Nepal. Furthermore, he claimed that 69% female respondents of the study experienced an increase in decision making a role in their household activities. Also, a few investigations affirm that access to microfinance enhances the financial position of families by giving them more chances to explore opportunities to increase income level. Similarly, Srinivasan (2009) assert that microfinance is a tool to provide more opportunities to low-income groups by providing capital investment. People having a weak financial position are unable to get a loan from commercial banks hence, MFI's are the only way to get a loan for deprived groups. Many microfinance institutions (MFIs) offer opportunities for the poor to become entrepreneurs and earn income. However, a large imbalance in penetration of MFI's in both across and within South Asia countries due to the fixed cost of loans treated, high risk of default and the higher interest rates of MFI's as compared to the conventional banks (Lützenkirchen & Weistroffer, 2012). USAID introduced the microfinance program in Egypt in the 1980s' with the collaboration of ABA and NBD. Later on, in the decade of 1990's many banks and NGO's started microfinance programs to support financially deprived groups of the Egyptian population. The Egyptian authorities take up the microfinance sector and developed a national policy in 2004 to support microfinance activities. Although the government took interest to support microfinance activities but still MFI's does not perform up to the mark. This investigation aimed to explore the factors that are affecting the growth of microfinance institution in Egypt despite the fact that it has great effects on poverty reduction. In this study, we want to explain the reasons or hindrance faced by microfinance institution to grow in Egypt. This study is an effort to enrich the literature on microfinance by exploring the difficulties faced by microfinance institutions in a socio-economic environment of Egypt. This study is unique in nature as no such study has found in this area in the Egyptian context. Moreover, socio-economic condition of Egypt is different from other south Asian countries. The results of this study will open new endeavours for practitioners and academicians in the phenomenon under study to realize the on-ground situation of Egypt.

This investigation is carried out in two phases; in first phase we review the existing literature to identify the factors influence the performance of MFI's. We use specific keywords to find relevant material from secondary sources such as journals, books, newspapers, reports, databases, etc. In the second phase of this study we conducted interviews from selected respondents to identify the critical factors affect the performance and growth of MFI's in Egyptian context.

LITERATURE REVIEW

A few examinations have recognized a few factors that impact the growth and sustainability of microfinance institutions. The financial companies need stability in financial operation to smoothly operate (Tiwari, 2012). While microfinance institutions need to generate funds by keeping in mind the end goal is to reserve funds for survival (Hermes, Lensink & Meesters, 2011). Moreover, Microfinance institutions need to minimize operating expenses to become more efficient (Adongo & Stork, 2005). Furthermore, it is very difficult to attract funds for microfinance institutions as investors are interested in certain returns. The above discussion revealed the importance of financial sustainability for the success of microfinance institutions.

The microfinance institutions performance and growth is increased when lower interest rate is charged (Ahlin, Lin & Maio, 2011). Morduch (1999) revealed that MFI's usually charge higher interest rate as compare to commercial banks caused hindrance in poverty alleviation. The higher interest rate often increases the risk of non-performing loans as mentioned by Hulme &

Mosley (1996). The MFI's with higher level of non-performing loan use unethical practices to recover loan payment which ultimately leads to shut down the operations of MFI (Shylendra, 2006). However, Wangechi (2008) argued that the composition of interest rate should be optimal for borrower as well for MFI to cover its operations cost to survive and able to supply the funds in future. An investigation carried by Bureau (2014) revealed that most of the borrowers think that interest rate charged by MFI's is not fair enough which cause difficulty in loan payments. In contrast Town (2017) suggests that microfinance institution should charge high-interest rate to recover cost and ensure long-term sustainability. The MFI's are facing high fixed and overhead cost due to specific business model therefore when MFI's reduce interest rate to accommodate more people ultimately increase more cost (Natalia, 2013).

The growth and development of microfinance institutions also depends on political condition of the country. The political pressure to accommodate more creditors and overstaffing in Asian countries leads to the inefficiency of MFI's (Akoijam, 2012). The unstable political condition leads to inconsistent policies which ultimately affects the performance of microfinance institutions (Gobezie, 2005). As said by Alemayehu, Muluken; Lemma (2014) the political and economic condition of country also very crucial for the success of MFI's such as, the supportive legal framework of country will help MFI's to perform better. Contrary, to these argument Ashta & Salimata (2012) assert that political instability does not have a significant impact over the performance of microfinance institutions. This argument also needs to be verified in the context of Egypt. The fraudulent activities have also been noticed in microfinance institutions. The proper accounting procedures should be followed to overcome this issue. The managers have found with abusive use of their powers. They utilized institutional assets and funds for their own advantages. Marulanda (2010) discovered that microfinance credits were sanctioned to relatives who were not qualified for these advances. Corruption in microfinance institutions have very different forms like managers are going to arrange and attend unnecessary meeting, conferences and seminars which incurred heavy cost to institution (Natalia, 2013).

Customer outreach is an important element for the growth of microfinance institution as well as to serve large number of poor people who are financially deprived. It is important for MFI's to reach large number of people for long-term sustainability on the other hand to achieve economies of scale (Natalia, 2013). The customer outreach is a difficult task as it increases more cost which ultimately hurts the efficiency of MFI's (Chin & Nor, 2016). Hoque, Chishty & Halloway (2011) also addressed the issue that customer outreach incurred extra cost which in turn creates leverage problems. On the other hand, it is noted that MFI's operating in a limited area are not profitable (Alemayehu, Muluken; Lemma, 2014). Ashta & Salimata (2012) explored that outreach of MFI's is having a significant role in the performance of microfinance institutions. Similarly, Seibel & Torres (1999) argued that by increasing outreach of MFI's, many underdeveloped countries have reduced poverty. The donor support has a crucial role in customer outreach as it increases the operating cost which in turn affects the efficiency of MFI's (Wangechi, 2008).

The importance of technology in this new digitalize world has grown over the period of time. Businesses are investing in new technologies to become more efficient and reduce cost. Laszlo & Cooperrider (2010) suggest that by introducing technology in MFI's such as online application system, Use of technology for monitoring of borrower and advertising the product information can reduce the cost substantially. Moreover, efficiency of staff can be improved by introducing the technology for internal management of business (Town, 2017). Chan & Thakor (1987) mentioned that in this globalization era the use of technology is inevitable to increase the

value in business. Similarly, Alemayehu, Muluken & Lemma (2014) suggest that by taking technology initiatives MFI's can reduce transaction cost, improve staff skills, strengthen recovery system and achieve sustainability.

RESEARCH DESIGN

The nature of this study is distinct in highlighting the issues that hinder the growth of MFIs in Egypt. Therefore, descriptive research design has been chosen to effectively address research objectives. To identify the factors, influence growth and penetration of MFI's in Egypt we conducted structured interviews from selected respondents. Relevant literature is referred to construct the questions of interview. Moreover, the respondents were asked to rate their opinion on a 5 point Likert scale. The respondents of this study are the top managers and mid-level managers as they have the relevant information and holds strategic positions. Purposive sampling technique has been adopted in this study to collect the responses. In total 130 respondents were contacted for interview out of which 112 respondents were interviewed from different microfinance institution in Egypt. The response rate is 86% which is adequate to generalize the results of this study (Sekaran, 2003). The purpose to conduct the interview was to give respondents, a better understanding with questionnaire. The interviews have conducted either face to face or telephone. The data analysis was carried out by using SPSS 20.0 version. The reliability of questionnaire was measured through Cronbach's alpha Nunnally (1978).

DATA ANALYSIS AND DISCUSSION

The respondents were asked to record their responses on a verity of questions related to identifying variables from literature. The internal consistency of responses was measured by using Cronbach's alpha. Table 1 shows the result of Cronbach's alpha whereas all the variables are above the threshold level ($\alpha > 0.70$).

VARIABLES	CRONBACH'S ALPHA
Interest Rate	0.73
Politics and Economy	0.78
Corruption	0.81
Customer Outreach	0.77
Competition	0.71
Technology	0.80
Interest Rate	0.73
Politics and Economy	0.78

Table 2 presents the results of responses collected through structured interview. The study found that technology is the most significant hurdle for MFI's with a mean score of 4.60 and S.D 0.41. All the respondents were agreed that MFI's are divested in adopting new technology for management of internal affairs as well as client management. The second highest rated hurdle is customer outreach with mean score of 4.17 and S.D is 0.67. It is noted that customer outreach is very challenging task to mitigate in the current scenario. The MFI's need to identify an optimal level between customer outreach program and operating cost. The effect of customer outreach program is twofold; it is crucial for poverty alleviation and long-term

sustainability of MFI's, on the other hand, it brings extra cost which in turn pose a threat for further growth of MFI's.

The respondents assert that managers are found to misuse their powers such as praise friend and relatives and attending unproductive seminars and conferences which incurred heavy cost for institution. The proper monitoring and control system should be adopted to mitigate this problem. It is also noted that MFI's are charging high-interest rate due to small loan amount and high operating cost. The mean score for interest rate is 4.01 with standard deviation of 0.46 which illustrates almost all the respondents agrees that interest is ample enough to smoothly operate the MFI's. The MFI's are charging high-interest rate which is adequate to cover all costs. In addition to this, respondents agree that high-interest rates impose burden on creditors and ultimately leads to inability of repayment. Moreover, the clients also feel pressure due to short time for loan repayment usually 60 to 90 days. It is very difficult to start a small business and achieve stable earnings within 60 days. Similarly, donors should reduce their expectations for return and the government should offer subsidy for MFI's to offers low-interest rates. Consequently, some respondents suggest that initiatives should be taken to raise funds from donors on Islamic principles such profit loss sharing. For the purpose MFI's should train and monitor business activities of creditors to minimize the chances of loss.

Good political and economic conditions are necessary for growth of business. The result portrays that political and economic situation is moderately affecting the performance of MFI's in Egypt. The mean score is 3.80 with standard deviation of 0.81. The respondents agree that legal framework does not support MFI's while interference of political figures is not very high. The respondents are very dispersed in their responses on competition which makes this factor a weak hindrance for the growth and penetration of MFI's in Egypt.

In the last, competition is rated least important factor for sustainability of MFI's in Egypt with mean score of 3.55 and D.S is 1.06. The results illustrate that competition is not very high in Egypt. It noted that variety of many MFI's financial products stimulate the clients to avail loan from multiple sources. The access of credit leads to default.

Factors Affect the MFI's Penetration and Growth	Mean	S.D	T-Value	Sig.
Interest Rate	4.015	0.46	1.228	0.022
Interest rate of MFIs are fair enough to survive in long-term	4.21	0.08		
The interest rate charged by your institution is fair enough to cover all costs	4.45	0.12		
Do you think that high-interest rate charged by the MFI's effects the growth of MFI	3.23	0.81		
The higher interest rate charged by MFI leads to indebtedness of clients?	4.12	0.84		
Politics and Economy	3.80	0.81	1.128	0.032
Legal framework of the country does not support the MFI's to smoothly work	4.28	0.80		
The current economic condition does not support MFI's to smoothly run their operations?	3.62	0.92		
Do you face any pressure from political figures for accommodating clients when they are not fulfilling the criteria for loan approval?	3.52	0.73		
Corruption	4.01	0.353	0.831	0.050
The managers misuse their power in MFI's	3.686	0.12		

The managers intentionally incurred extra cost to institution from unproductive activities	3.76	0.52		
Do you think that the misuse of power affects the growth of institution?	4.59	0.42		
Outreach	4.17	0.67	0.844	0.040
Is customer outreach a challenge for MFI's in current situation?	4.42	0.68		
Increasing the customer outreach brings extra cost for MFI's	3.96	0.76		
Do you think customer outreach is an important hurdle for the success of MFI's	4.15	0.59		
Competition	3.55	1.06	1.65	0.043
The competition among MFIs create hindrance for success of MFI's	3.32	1.32		
The entrance of commercial banks in microfinance activities intensify the competition	3.25	0.89		
The of variety of Microfinance products instigate the customer to access credit from multiple source	4.08	0.93		
The access of credit from multiple sources leads to indebtedness	3.92	1.12		
Technology	4.60	0.41	0.967	0.021
The MFI's use adequate technology to manage internal operations	4.79	0.25		
The MFI's use adequate technology to access and monitor customers	4.28	0.55		
The use of technology can reduce operating cost for MFI's	4.62	0.45		

CONCLUSION

The scheme of microfinance is to provide small loans with other services like entrepreneurship guidance, insurance, etc., (Sinha, 1998). Microfinance is a tool to provide more opportunities to low-income groups by providing capital investment. This investigation aimed to explore the factors that are affecting the growth of microfinance institution in Egypt despite the fact that it has great effects on poverty reduction. The results revealed that lack of use of technology and customer outreach are the main hindrances for growth and penetration of MFI's in Egypt. Corruption and high-interest rate also pose hindrance in the success of MFI's in Egypt. Accordingly, political support is necessary to get success in poverty alleviation by providing strong legal framework. Competition among MFI's is not so high but it could create hurdles in future hence, proper planning and policy for MFI's is advised to mitigate the future hurdles.

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