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An Appraisal of Risk Management Practices of Microfinance Institutions in Ghana

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Abstract
The inherent features of microfinance institution afford these institutions the potential to absorb unskilled and semi-skilled labour to nurture as well as promote small scale enterprises. However, in the Ghanaian economy, these benefits are not forthcoming due to the high failure rate of microfinance institutions. Relevant literatures were reviewed to bring out salient issues on the subject matter of this paper. The chief source of information for this write up is secondary method of data collection. It was discovered that the barriers to microfinance institutions success includes numerous and varied obstacles. Studies conducted confirmed microfinance institutions managements are ignorant pertaining to the risks their organizations face with risk management techniques deployed reactively and ineffectively. By embedding a structured approach to enterprise risk management within MFIs, potential benefits such as reducing the over-management of risks and organizational alignment towards the microfinance institution's mission can be realized.
Keywords: Microfinance institution, risk, risk management, strategic risk management.

1. Introduction

Microfinance institutions (MFIs) operate in the same environment as the universal banks, but without the associated benefits such as ample capital and extended human resources of the universal banks. MFIs encounter increasing competitive pressure fuelled by globalization, financial reforms and financial services liberalization including the relaxing of trade barriers, as well as an increase in market expansion due to technological advancement and innovation. MFIs often flourish on their malleability and agility such as their close proximity to their clients, their candidness towards new ways of working, and their risk taking approach, but many MFIs are prone to key external shocks (Mensah, 2004; Akanji, 1998). Although MFIs experience difficulties in absorbing and coping with these obstacles, they need to develop an ability to deal with the ever increasing challenges, that is, risks faced by the organization (Ledgerwood, 1999).

MFIs management needs to amplify the significance of risk identification and minimization in their organizations or they can suffer cataclysmic consequences if they are ill prepared for the result of a possible risk. This requires that management in MFIs need to be familiar with risk identification and analysis to manage risks from a varied range of sources (Schultz, 2001). By integrating risk management into MFIs operations, MFIs are better equipped to exploit their assets, thereby enabling MFIs to transform expense activities into undertakings that can produce a positive return (Steinwand, 2000).

2. Literature Review

2.1 Defining Microfinance Institutions (MFIs)

Microfinance has been defined as a development tool used to create access for the economically active poor to financial services at an affordable price (CBN, 2011). It is the provision of credit and other financial services to the low-income group and micro entrepreneurs to enable them build sustainable microenterprises (Otero, 2000; Nkamnebe, 2008; and Muktar, 2009). The Syngenta Foundation Discussion (SFD) is quoted by Seibel, 2007 to view the concept from a more general perspective. SFD defined the concept to include provision of small-size financial services especially but not limited to the lower segment of the rural and urban population. These financial services are provided by formal and informal financial institutions; both small and large. A microfinance institution (MFI) or bank (MFB) is any company licensed to carry on the business of providing microfinance services (CBN, 2005).

2.2 Significance of MFIs to the economy

The significance of MFIs is acknowledged in various African countries such as Uganda, Nigeria, Kenya, as well as others. According to Buckley (1997), MFIs are dominant in numbers in financial sector of least developed economies. In developing countries where MFIs has been accepted as an alternative financial inclusion strategy for the poor and the low-income earner, the MFIs success is considered far more significant than in developed countries (Basu et al, 2004). The activities of MFIs in Africa are of vital significance for the promotion of economic development, job generation and the alleviation of poverty.

Conversely, research conducted on MFIs in Africa by Basu et al (2004) confirmed that on average, there are more MFIs closures than expansions, with approximately only 5% of MFIs growing from seven or less employees to ten or more. It has long been argued that MFIs are vital to employment generation and economic development, particularly in countries such as Ghana that has a high unemployment rate, estimated at 15% (www.modernghana.com). Enhancing the roles of the MFI sub-sector in the Ghanaian economy to improve economic development through increasing competitiveness, and by generating employment and redistributing revenue (Andah et al, 2003), has been the focus of new development policies since the democratic transition (Bank of Ghana, 2007). In order to aid in the facilitation of the MFI environment, the Ghanaian government tabled the Non-Bank Financial Institutions Act of 2008 to provide equal standing to MFIs (Bank of Ghana, 2007) in Ghana's economy.

The indispensable role the MFIs sub-sector plays in the Ghanaian economy in addressing sustainable development was highlighted by Mr. Settor Amediku, Deputy Head of Financial Stability Department at the Bank of Ghana (www.ghanaweb.com). The MFI sub-sector is one of the largest promoters of MSEs in Ghana. The MFIs is not only seen as an employment creator, but the micro-credit loans have improved the economic lives of at least three million Ghanaians in the last decade according to Roderick Okoampah Ayeh, Microfinance Technical Officer at Accra-based ARB Apex Bank, (www. ghanaweb.com). It is noted that the majority of Ghanaian MFIs are micro and survivalist institutions which display no signs of organization development due to low capital and inadequate organization dynamics, resulting in MFIs conservative contribution to employment compared to other countries. Even in dynamic Ghanaian MFIs, it seems that a 'workless growth' strategy is employed.

The Ghanaian government has identified the MFIs sub-sector as the means to realize accelerated financial inclusion particularly for poor clients in less economically endowed areas and economic development. However, this objective was not attained partly due to the high failure rate of 36% of MFIs (business.myjoyonline.com) in the MFI sub-sector. As MFIs growth is influenced to a larger extent on the macro economic growth, it can be said that the sluggish microeconomic growth of the past few years has inhibited entrepreneurial performance and therefore MFIs to grow to their full potential (Ghamfin, 2006). MFI failure can be partly attributed to the lack of management skills, knowledge and abilities. Ghanaian MFIs just like other MFIs in other parts of the world do not aspire to corporate governance best practices (Labie, 2001). Risk management, a constituent of corporate governance, is therefore, also regarded as an elective organizational activity, and not as an essential constituent to organizational success.

2.3 Essential success factors for Microfinance Institutions (MFIs)

Caution should be levied against viewing MFIs as smaller versions of larger financial institutions as MFIs do not in any regard bear a resemblance to universal banks. Generally, MFIs experience a dearth of resources (Brau et al 2004) such as time, financial and human resources.

Research studies have identified a number of factors that influence institution expansion and success. A fundamental constituent (McGrath et al, 1996) that has a positive impact on an organization's development is the depth of "human capital" or "brain power". The significance of human capital as a critical success factor was also confirmed in a study conducted on African businesses where it was determined that successful organizations are more likely to have workforces, management etc with education and training beyond the primary school level (Rogerson, 2001).The significance of this finding is based on the argument that institutions with employees having a greater level of education and training are more able to adapt business operations to the ever changing business environment.

In a study conducted on institution success factors in MFIs in Sub-Saharan Africa, it was concluded that a lack of technical and managerial skills (CGAP, 2009, Market Information Exchange (MIX), 2009) inhibits on business development. Research studies conducted on MFIs failures in Ghana revealed that failure was primarily caused by a lack of management skill and training. This finding is confirmed (Asiama et al, 2007) by 70% of a sample of 400 entrepreneurs who believe that MFI failure is due to a lack of managerial skills. However, taking the significance of training and skills into account, it is cautioned by Asiama et al (2007) that skills are not the only or even primary solution to the challenges facing MFIs development.

It can be garnered from various literature sources (Nair et al, 2010; Hayder, 2002; Bank of Ghana, 2007; Ghartey, 2007) that a high percentage of micro and small organizations fail in the first five years of operation, often as a result of over trading and financial strain. Access to finance has therefore featured conspicuously in a number of studies as a constraint on MFIs development. According to Robinson (2003) and Ledgerwood (1999), a lack of credit is a key constrain experienced by emerging African MFIs, which depends on personal savings of promoters, loans from relatives and friends of promoters or donor funds, as the source of their start-up capital. Skills, business training, finance and less rigid regulations are the key elements to promote entrepreneurship, to improve the business environment, to improve competitiveness and capacity in the MFIs (Rogerson, 2008).

2.4 Challenges faced by MFIs in Ghana

MFIs management are most conversant with their institutions, but are frequently not able to identify all the factors impacting on their organization undertakings and/or exaggerate the significance of external factors, while thinking little of internal weaknesses (Kesper, 2000). According to Asiama et al (2007), challenges experienced

by MFIs in Ghana include the following:
There is an overlap in some cases of roles and responsibilities of stakeholders. The overlap is due partly to the poor definition of reporting relationship among organizational and institutional hierarchy.
Secondly, the staffing and competency levels are still below what is desired, because of their inability to attract and retained high caliber of staff due to poor staff remuneration packages. MFIs are therefore grappling with high employee turnover. In addition, microfinance Apex bodies lack an adequate cadre of in-house trainers and/or facilitators as well as in-house monitoring and assessment divisions to constantly measure progress of their activities consistently over time.
Thirdly, there is lack of information on MFIs, their operations and customers in the nation. The methodology for data and information gathering at the nationwide level are poorly defined, making it challenging to centrally monitor progress of the MFIs sub-sector. Also, there is a lack of well-defined reporting system by both the regulator and development partners with regards to their interventions, and hence there is inadequate database for decision-making and planning. Furthermore, lack of common benchmarks, methods for measuring and information sharing inhibits the performance of the sub-sector.
Fourthly, MFIs that operates small branches which are physically linked by weak transportation and communications infrastructure or "susu" operators that have several field staff, monitoring branch activities or field officers activities to prevent internal fraud is a major challenge. This challenge has resulted in several fraud cases where field officers under record the actual deposits or repayments of their clients. A contributory factor to this challenge is as result of the MFI poor bookkeeping practices.
Fifthly, the proposed upward adjustment of paid-up capital GH¢ 500,000 ($207,500) has put undue pressure on smaller companies to meet it and the revised operating rules and guidelines has added on more cost to already high operational cost which subsequently affect the interest rates charged by the MFIs.
Sixthly, there is no formal body that is responsible for coordinating all activities associated with microfinance, nor is there a forum for dialogue among stakeholders on policy and programs issues. This has resulted in fragmentation, duplication and inadequate collaboration between and among various stakeholders.

3. Methodology

In writing this paper the researchers principally used existing literatures and records relevant to the subject matter of this paper. Using deductive approach, the researchers were able to draw conclusion having critically reviewed salient issues in existing literatures and records. This method was adopted because time would not permit the use of questionnaire which ordinarily has to be administered to a sizeable number of micro finance banks across the country. However, reviewing related works by other researchers gave a deeper insight to the researchers which enabled us to draw reasonable conclusion.

4. Analysis

4.1 Exploiting risk

According to Plourd (2009) the significance of risk management is now heightened above issues such as long-term and short-term funding constrains. Declaring the existence of a risk management strategy is inadequate, MFIs need to aggressively engage in risk management practices to address the convergence of key risks as experienced in the current economic environment where the credit crunch risk, fluctuating commodity prices, increased government debt, rising unemployment and declining consumer spending are impacting individually and combined, on organizations.
The use of enterprise risk management (ERM) can be regarded as a business competency enabling management to optimize opportunities associated with risks (Hofmann, 2009). ERM should apply basic risk management activities, embedding the risk champion's knowledge of exposures, across the whole scope of an organization's risks such as strategic risks, operational risks, liquidity risk, financial risks and regulatory compliance risks (Cendrowski, 2009), and should not be reduced to a practice based solely on risk formula's (van Greuning et al, 2000).
A well-thought-out risk management method enables an institution to pursue its strategies aggressively and efficiently as management can expect the risk exposure of each activity engaged in, thus attaining more satisfactory results at a reduced cost (Uyemura et al, 1993).

4.2 Risk management for MFIs

Risk and risk management is a foremost concern for all financial institutions, especially MFIs which are particularly sensitive to credit risk, liquidity risk, market risk, operational risk and competition (Stolow et al, 1999). In MFIs, the risk management function is usually vested with the board of directors' assessment of threats and opportunities relating to the institution (Furash, 1994). Although risk management philosophies are common to all types of financial institutions, the management's risk perception and their attitude towards risk management influences the adequacy of the institution's risk management actions used (Uyemura et al, 1993).

Implied in MFI, risk management is the fundamental norm that management effort should be focused at recognizing future uncertainty, deliberating risks, possible indicators and effects, and formulating plans to address these risks and reduce and/or eliminate its impact on the institution (Uyemura et al, 1993). One of the skills required of management is their ability to recognize and analyze risks to ensure that advantage is taken of calculated risks (Nocco et al, 2006). According to Steinwand (2000), MFIs should take regard of the following steps in their risk management process: a). Establishment of MFIs' risk strategy; b). Determination of MFIs' risk enthusiasm; c). Identification and evaluation of risk; and d). Prioritization and management of risks

The fact that a risk is beyond the control of the management, does not absolve the management from the need to expect the risk, and reducing the impact of the risk occurrence to accomplish organizational goals. MFIs should take cognizance of managerial risks that arise as a result of the board's own actions when planning and executing business strategies (Bald, 2000). Ghanaian MFIs should be educated in risk management doctrines, risk handling techniques available and risk control programs that can be used, but care should be taken in the application of risk management philosophies, as although risk principles are common to all types of organizations, the application thereof varies substantially between MFIs and universal banks. However, many MFIs practice instinctual risk management when they evaluate the risk involved in decisions (Uyemura et al, 1993).

4.3 Components of risk in MFIs

Determining the constituents of total risk in MFIs is multifarious due to MFIs great dissimilitude as well as obstacles in separating business from management (Newton, 1993). Entrepreneurs have inferred (St-Pierre et al, 2006), varying (Mueller, 1993), and in most instances, distinctive objectives that utilizes both direct and indirect influences on management practices, rendering comparisons between MFIs problematic. Information derived by way of financial data analysis cannot yield all the dimensions of organization performance, as emphasized by St-Pierre et al (2006). Strategic information such as quality, customer satisfaction, and novelty reflects the organization's competitiveness and performance, but are not forthcoming in the revenue earned. Nieman et al (2009) opine that long term sustainable financial performance is attributable to non-financial factors like internal processes, employee satisfaction as well as brand and customer loyalty. This view is shared by Ittner et al (1998) who states that the investment in intangible assets, that is, customer satisfaction, is not accommodated in the accounting data. The same argument applies to the risk of an institution that is difficult to understand if attention is solely directed at the financial statements. Through the integration of non-financial information, the challenges associated with the manipulation of financial statements are minimized. By following a systematic approach and by taking into account both financial and non-financial information related to the institution, an improved understanding of MFI risks can be achieved (CGAP, 1999).

4.4 Microfinance institutions inadequately manage their risk

Few MFIs management and employees are risk aware and focus their risk actions on "loss control" programs in areas of fire, safety, security, health, and quality assurance. These "loss control" programs are overseen either by the board or other management along with their other duties; therefore, increasing the chance of mismanagement as adequate time is not spent on the risk function. As no structured risk identification is undertaken by MFIs, MFIs assume unaware and/or unplanned risk exposure to their limited financial and non-financial resources. Control measures implemented to counter risk are ineffective and inefficient as controls are reactive and non-automated (Uyemura et al, 1993).

To limit the effect of risks on the institution, risks needs to be managed once it has been identified. In MFIs, the control of risk exposure is construed reactively, holding calamitous consequences for the institution as losses are taken on while the organization is ill prepared to finance the loss. In most MFIs, risks are left unmanaged till it is realized, only then goading on action to address it (Steinwand 2000). Uyemura et al, 1993 confirms that MFI management and employees are not knowledgeable in the availability and use of risk reduction practices to minimize the hostile effects of risks on the organization. It can be garnered from the interviewee results that management prefer avoiding risks, but they fail to take into account that every risk action undertaken by them has an effect on the risk pattern. Thereby, although a specific risk is avoided, the impact of other risks may change and new and potentially serious risks can be created. The study identified that managerial actions are centered on avoiding risk, rather than devising risk control techniques. This impedes on the economic development of a nation as every institution can be defined by its ability to take on greater risks. Apart from risk avoidance, the study identified risk transfer as the alternative risk technique used by MFIs, whereby insurance underwriters were contracted to undertake all risk actions, that is, risk identification, risk evaluation, risk control and risk financing. Risk retention methods whereby risks are funded by internal reserves such as current revenue are little known and infrequently applied in MFIs (Uyemura et al, 1993).

5. Conclusion

The obstacles to MFI success are myriad and diverse, and include inherent organizational problems such as poor managerial skills, training and education; industry-related problems such as the management's inability to understand market outlooks, and poor market access; and economy-based impediments such as lack of funds and interest rate fluctuations. MFIs boards of directors are primarily responsible for the management of their organizations' activities.

Research studies carried out by Steinwand (2000) and Mago et al (2013) confirms MFI managements' ignorance pertaining to the risks their organizations face from internal and external sources, including risks stemming from managerial actions. MFI risk management methods are predominantly limited to risk avoidance actions, and to a lesser extent, risk transfer through insurance underwriting activities. Most risk activities of MFIs tends to be construed reactively, thereby affecting the availability of organization resources in addressing these risks. By embedding a well-thought-out method to risk management within MFIs, potential benefits such as cost control and reductions, reducing the over-management of risks and organizational configuration towards the MFI's mission and aims can be realized.

5.1 Rationale for developing a strategic risk management strategy

MFIs operate in a macro, micro and market environment that is affected by numerous internal and external influences which unremittingly change. These 'change factors' assists management to identify opportunities and threats (Chan, 1997). It is therefore vital that an MFI has the know-how to assess decisions to determine the organization's future strategy (Larr, 1993). Strategic risk management allows MFI management to impartially appraise their actions. One of the challenges faced in risk management is that most risk assessments are linked to a specific discipline which is not necessarily known by management. Furthermore, management may be able to identify the obvious risk, but their depth of risk knowledge may impede on their undertakings to identify indirect risks, or to take cognizance of the interconnectness of risks (Larr, 1993). Steinwand (2000) emphasizes that board of directors should develop a risk strategy to avoid, lessen or respond to potential risks. It is therefore crucial that management and employees are armed with the needed skills to compare risks and to identify appropriate risk strategies in sufficiently addressing these risks. Depending on the specific circumstances, management should engage in actions limiting the likelihood of risk occurrence, or if need be, to plan tactics that maximize the likelihood of recovery (Larr, 1993). By embedding a strategic risk management strategy in the MFIs operations, significant gains can be achieved, such as (Ow, 2007): i). Ensuring those MFIs activities are aligned to its mission and aims, and not diverted by external influences. ii). Ensuring that organizational activities comply with industry best practices and that regulation framework compliance is achieved. iii). Providing legal protection if challenges occur. iv). It may result in cost savings by reducing insurance expenses.

Strategic risk management assists an effective risk method by prioritizing risks, thereby reducing bombshells, and directing the focus on significant risks. This has the effect of reducing the possible over-management of insignificant risks. In the risk management process, management should be aware that risk actions should be tailored to the specific requirements of the organization taking into account its resources, needs and opportunities that prevail. Although risk evaluation should be a comprehensive function, guard should be taken into formulating an superfluous risk strategy (Paasi et al, 2007). Given the size and managerial structure of MFIs, the process of establishing and using a strategic risk management function is relatively simple given the close relationship between owners, management and employees of the organization. Compared to universal banks, it is easier for MFI management to embed a risk management policy and to be consistently and enthusiastically involved in the application of the strategic risk management policy, especially if these activities is seen as a performance enhancing procedures (Ricondo et al, 2006). In a study conducted by Ghamfin (2006) on Ghanaian MFIs, it is emphasized that personal initiative consisting of the owner's characteristics such as being a self-starter, having a proactive approach, specifically regarding risk management, and persistent actions, is a vital key to organization success. In addition to a proactive business approach, innovation and learning, objective setting and accomplishment orientation was linked to organization success. Where MFI managements follow a reactive business approach including reactive risk management practices, the institutions were more likely to fail. MFIs management need to be aware that through joint discussion of risk with MFI employees, which include an effective feedback process and a risk valuation process, organizational trust is established. The way of conducting risk management, that is, the nature of the risk management process will depend on all the stakeholders risk predilection as well as the situational control that is exercised at present. Therefore, risk tolerant employees may prefer an informal risk review process, while risk adverse participants will favour comprehensive contractual arrangements (van Greuning et al, 2000).

Empirical evidence suggest that the creation of a positive organizational risk culture whereby all stakeholders concerns are understood and experiences are shared, is facilitated through a constant evolving process of risk identification and the planning of containment strategies. Moreover, combined proactive identification of risks, and by employing holistic risk management practices, management can establish a positive environment to deal with all issues. Irrespective of the risk propensity of the members, a structured approach to risk management will assist in providing a goal orientated and consistent risk management process (Steinwand 2000).

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