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Reconciling Commercial (Universal) Banking with Microfinance Institutions in Ghana, Case Study: Greater Accra Region

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Abstract

The study focused on reconciling commercial banking with microfinance institutions in the Greater Accra region. The study identifies that microfinance institutions were not able to eradicate the poverty level among Ghanaians which calls for the indulgence of commercial banks to rescue the nation from poverty through the provisions of some of the microfinance services. The study uses a sample size of 500 respondents and adopted both descriptive and quantitative analysis. The descriptive analysis takes into accounts both pie charts, bar-graphs and tables whereas the quantitative analysis used both probit and Ordered probit regression model to analyze whether or not commercial banks are providing microfinance services and their level of performance in executing the role of the MFIs respectively. The main objective of the study was to identify the role of commercial banks in comparison to that of Microfinance institutions and to further examine the extent to which commercial banks meet the criteria of MFIs as well as some challenges the commercial banks faced. The study also revealed that door-to-do banking services are offered by both commercial banks and Microfinance institution. The study finds out that the structures (administrative staff, logistics, collateral requirements, etc) that are required for the operating of microfinance services on the market are completely different from that needed to offer pure commercial banking services. The study further finds out that high default rate among customers seems to be part of the major challenges the bank faces in discharging microfinance services. In the nut-shell the study revealed that commercial banks go out of their various banking halls to the individual on the market often times to promote/ market their product available in the banks and not necessarily offer microfinance services to petty traders and other small business units.

Keywords: Microfinance, commercial banks, financial institutions, loans, savings

1. Introduction

The polemical goal of Ghana’s Growth and Poverty Reduction Strategy (GPRS II) is to ascertain “sustainable equitable growth, accelerated poverty reduction and the protection of the susceptible and excluded within a decentralized, democratic milieu”. The objective is to eliminate widespread poverty and the increasing income inequality, especially among the prolific poor who amount to the majority of the working population. According to the Population and Housing Census (2000), 80% of the working population was found in the private informal sector. This group is characterized by lack of access to credit, which constrains the development and growth of that sector of the economy. This surveillance was accentuated in the International Monetary Fund Country report on Ghana in May 2003 that “weaknesses in the financial sector that restrict financing opportunities for productive private investment are a particular impediment to business expansion in Ghana.”

This accounted for the introduction of microfinance in Ghana. The deprived people may have potentially profitable business ideas, but cannot materialize them because they lack sufficient capital for start-up costs. Generally speaking, microfinance institutions seek to reduce poverty worldwide. As they get hold of funds and services from MFIs, recipients gain enormous financial benefits, which trickle down to others in their families and communities. New business ventures can provide jobs, thereby increasing income among community members and improving their overall well-being. Microfinance services gives hope to people who previously had little or no opportunity to be self-sufficient. According to Mish kin (2007) microfinance engrosses the provision of small loans and other facilities like savings, insurance, transfer services to the poor, low-income household and microenterprises. Usually, the poor acquire financial services like loans through casual relationships. These loans, however, come at a high cost per cedi loaned and can be unreliable. In addition, commercial banks have not habitually viewed poor people as viable clients and often reject them due to rickety credit or employment history and lack of collateral. Throughout the years, the introduction of microfinance has proven to be viable in the course of eradicating poverty in the economy. Commercial banks, upon realizing the availability of a ready market for the products and services provided by microfinance institution, and the potential profitability that comes with the provision of these products and services, have started delving into the business of microfinance and are surprisingly thriving even though microfinance was initially not in their span of operations.

Why the sudden interest in microfinance by commercial banks? Astonishingly many commercial banks in developing countries are beginning to examine the microfinance market. Unwavering banking competition in many countries has forced some to diversify into new markets. Some seek a new public image. Others have heard about the profits of successful microenterprise banks. During the last ten years, their exploration of this new-fangled market has been facilitated by donor-funded loan guarantees, central-bank rediscount lines, and specialized technical assistance. Although the initial resources for loans frequently came from donor-funded credit programs, commercial banks in time began to draw on their own deposit sources for a growing share of their total funds for microloans. Given this background, the study sought to to probe the target group (clients type) of the commercial banks; spot challenges faced by commercial banks in the business of micro finance; corroborate the degree to which commercial banks congregate the criteria of MFI; and probe the revolutionizes in some banking variables (echelon of deposits, bad debts, tranquil collateral etc) upon going into the business of micro finance.

2. Literature Review

A study by Perera (2009) on commercial microfinance: a strategy to reach the poor. The study explores "downscaling" by banks as a model of microfinance commercialization that has used as a strategy to reach the poor. In order for the study to answer the main research question, an explorative case study methodology was chosen, based by a microfinance programme of a well-established commercial bank in Sri Lanka, the "Hatton National Bank". This study was based on commercialization debate areas; trade-off between sustainability and outreach, financial performances and impact on clients. The findings reveal that commercialization of microfinance gives rise to a trade-off between sustainability and outreach. However, protection against regulations, physical infrastructure, better know-how, greater access to funds, and enhanced capacity, make commercial banks the most qualified to meet the untapped demand of micro entrepreneurs.

A study by Delfiner (2006) on commercial banks in microfinance which aimed at exploring the main aspects related to commercial banks' provision of microfinance services and the future prospects for this activity. The study used primary source of data for its descriptive analyses. The study found out that several reasons have led banks to become engaged in the downscaling process, including microfinance profitability and growing competition in the medium-sized and large businesses financing market.

Larry Hendricks in February ,2000; conducted a case study in Ghana; this case study was based on the premise that a study of local culture can provide a significant contribution to the operation and development results of an MFI. To do this, the study focused on the operation of an MFI. Previous studies have demonstrated that MFIs, in order to be successful and sustainable, need to be bound to the local community in which they operate. This study used the case method to explore what local cultural systems could contribute to an MFI's operating methods. The case study focused on family and kinship systems in Ghana as the context for this exploratory study. Using a review of anthropological literature as a starting point and baseline, cultural traits that could impact on an MFI's operation were identified. The components of these traits were used to pose questions about how the local family and kinship systems might impact on an MFI operation. The purpose of these questions was to focus on cultural issues that were to be explored during the field work portion of the study. Using group and individual interviews the previously identified questions from the literature review were explored in the Techiman District of Ghana. One of the important findings was that the literature review not only provided a baseline for the study, but it also served as a means for establishing rapport in the interviews. In terms of MFI operations the findings were that the Ghanaian culture is in a significant transition. Also discovered were cultural norms, values and practices which provide MFIs the opportunity to leverage social capital to reduce risk, develop new products, and contribute to sustainability and measure impact (Larry H., 2000).

A study done by USAID Microenterprise Development Office (1997) on commercial bank in microfinance, adopted a primary source of data by interviewing 17 bankers attending the Commercial Banks in Microfinance conference in November 1996 at Washington, D.C. The study used a descriptive statistic to analyze the entire study. The purpose of the study was in threefold: thus to describe some of the issues facing all commercial banks interested in entering microfinance; to briefly document the experience of these 17 banks with microfinance programs; and given the small scale of most of these operations, to draw some conclusions concerning their future as large-scale providers of microfinance services. The study found out that, experience of private commercial banks in micro-finance is still relatively limited. Nonetheless, a few patterns are emerging, and a number of challenges continue to require attention.

3. Materials and Methods

Cross-sectional data were sourced across the Commercial banks in Greater Accra for the analysis of the problem and the objectives stated above. The study sampled both the management members and the co-workers of the following commercial banks in the Greater Accra region Ecobank, Barclays bank, Ghana commercial banks, Agricultural development banks, UBA, e.t.c. where most of their services have now been unmitigated to the neglected groups like farmers, students, SMEs, e.t.c. The sample size used in a study is determined based on the cost of data collection, and the need to have sufficient statistical power. The research study covered a sample size of about 100 management members and 400 workers of commercial banks in the region. The simple random sampling technique was used to select the commercial banks for the study and purposive sampling was used to select the respondents for the survey. Focus group discussions (FGDs), interviews with key informants and questionnaires were used for the data collection. The research used both qualitative and quantitative approach for data analysis in the study. The study used regression for the statistical analysis and presentation of the data gathered. The statistical criteria used for the evaluation of the research viability were both P-values and student Z-values. STATA and SPSS software were used for the data entry and the analysis.

3.1 Model Design

A set of two models are conceptualized in this section for the purposes of estimation. The first relates to whether the commercial banks offer microfinance services which is a binary response. The second is related to the degree to which commercial banks congregate the criteria of Microfinance Institution (MFI).

3.1.1 A Probit Model

A probit model has come into a fairly wide used as a framework for analyzing responses that comprises dummy or binary responses (Beggs, Cardell and Hausman, 1981) since the dependent variable (Y) of the model is whether the commercial banks will offer microfinance services or not is coded as a binary, the probit approach is used for estimating the regression function in equation 1 below

$$\Pr(CBM=1 \mid LCN, PDT, TGP, PFT, PTNS, SOC) = \Phi(\beta_0 + \beta_1 LCN + \beta_2 PDT + \beta_3 TGP + \beta_4 PFT + \beta_5 PTNS + \beta_6 SOC + \varepsilon \quad (1)$$

The dependent variable (CBM) of the model is whether the commercial banks will offer microfinance services or not. The explanatory variables takes into accounts the following location (categories of customers), products (funeral loans, Mobile banking, Child-education, life policy e.t.c), profitability, partnership and social obligation.

Where, the STATA coding for the logit regression estimation is as follows:

CBM= is a dummy variable, CBM=1 if commercial banks offer microfinance services and zero (0) otherwise

LCN=Location (Residential and Commercial area). LCN is dummy, equal to one if located at a commercial area and zero otherwise.

PDT= Nature of Products. PDT=1 if they offer mobile banking and zero (0) otherwise.

TGP= Target group (SMEs Corporate bodies, or Public servants). TGP=1 if they target SMEs and 0 otherwise.

PFT= Profitability. PFT =1 if they offer MFI services due to profit in the sector and zero (0) otherwise.

PTNS= Partnership with the MFIs. PTNS=1 if they merge with the MFIs and zero otherwise.

SOC= Social Obligation to Community. SOC=1 if Commercial banks offering Microfinance services is due to the social obligation to the community and zero otherwise.

ε=Error-term.

3.1.2 Ordered Probit Model

The Ordered-probit model and logit models have come into fairly wide use as the framework for analyzing rated or ranked responses (Zavoina and McElvey, 1975). The model is built around a latent regression in the same manner as the binomial probit model.

$OPr\ (DCM) = \Phi\ (\beta_0 + \beta_1\ LCN + \beta_2\ PDT + \beta_3 TGP + \beta_4\ PFT + \beta_5\ PTNS + \beta_6\ SOC + \varepsilon)$……………... (2)

Where DCM is the degree to which commercial banks meet the criteria of MFI. Where "DCM" rank from zero (0) to four (4); DCM =0 is "poor", DCM =1 is "fair", DCM =2 is "Good", DCM =3 is "Very good", DCM =4 is "Excellent".

3.2 *Expected Signs of Coefficients of the Variables in the Model*

The expected signs of all coefficients in the model (ie, LCN, PDT, TGP, PFT, and PTNS), were positive, implying that the likelihood of the commercial banks to provide microfinance services increase with these variables. However, that of SOC was expected to be negative, implying the probability of commercial banks to provide microfinance services decreases with SOC. The SPSS 16.0 was used to evaluate the descriptive statistics- bar charts and pie charts. The following hypotheses were tested:

i. Profit is a significant motivation for commercial banks to enlist micro financial service provision in the financial market.
ii. There are comparative advantages of commercial banks in microfinance activities over NGO, providing Microfinance services.

4. Results and Discussion of Findings

4.1 Descriptive Analysis

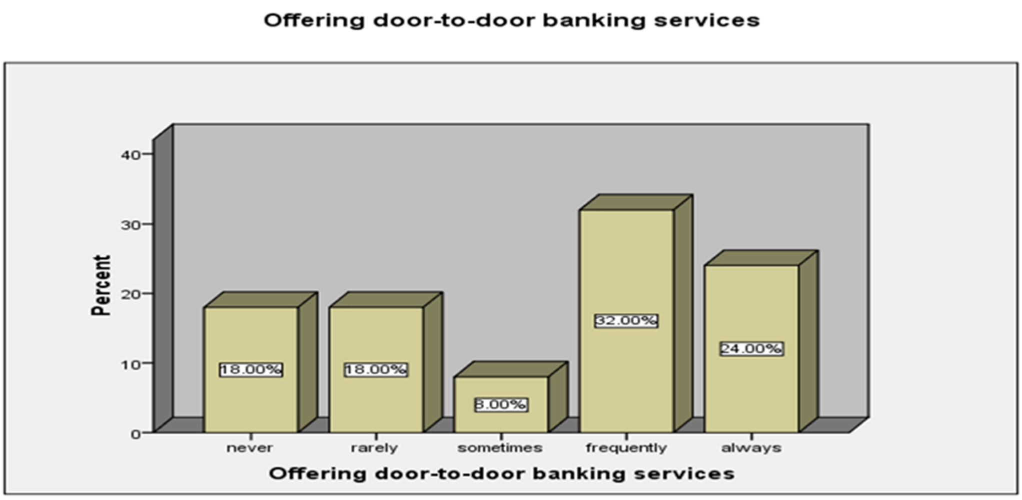

Figure 1. How Often the Banks Offers Door-To-Door Banking Services to Their Customers

Figure 1 demonstrates how often commercial banks issue banker's drafts to their customers such as individuals, SMEs, co-operate bodies, government workers etc. About 56% of the total banks interviewed have proven that they frequently and always offered door-to-door banking to their customers. Thus the majority of the banks was frequently and always goes to their customers for their bulk deposit, where 24% of the banks were always and 32% of the banks frequently offer door-to-door banking services to their customers. Also 8% of the banks sampled sometimes offer door-to-door banking to their customers, 18% of the banks rarely offer door-to-door banking to their customers and sometimes never offer door-to-door banking to their customers respectively

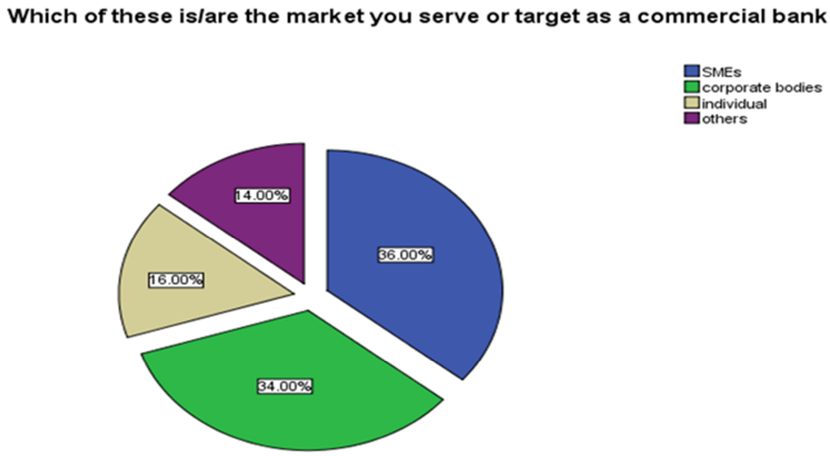

Figure 2. The Client Base for Commercial Banks Serve/Target Group for the Commercial Banks in the Greater Accra Region

Figure 2 shows the extent of the commercial banks area operation or the market they serve in the Kumasi metropolis or the target group for the commercial banks in their area of operation. Based on the data obtained, figure 2 reveals that commercial banks is no more serve only the corporate bodies only as in the case of their nascent stage of operation but now extend their scale of operation the individuals, SMEs, and other bodies or groups in their vicinity of operation. Thus from the figure 2, the data shows that currently SMEs forms the majority of their clientele with 36% of the total sample, follows by 34% for the corporate bodies which used to be the commercial banks main target groups but now not the main target group since the SMEs percentage outweighs the percentage of the corporate bodies. The banks also extend their market to the individuals with 16% and other groups such as students, civil servants e.t.c with 14% which now shows that the commercial banks has now extend their area of operation.

4.1.1 Frequency at which Banks Offer Microfinance Services: Susu Accounts, Lending Micro-Credit, and Technical Advice

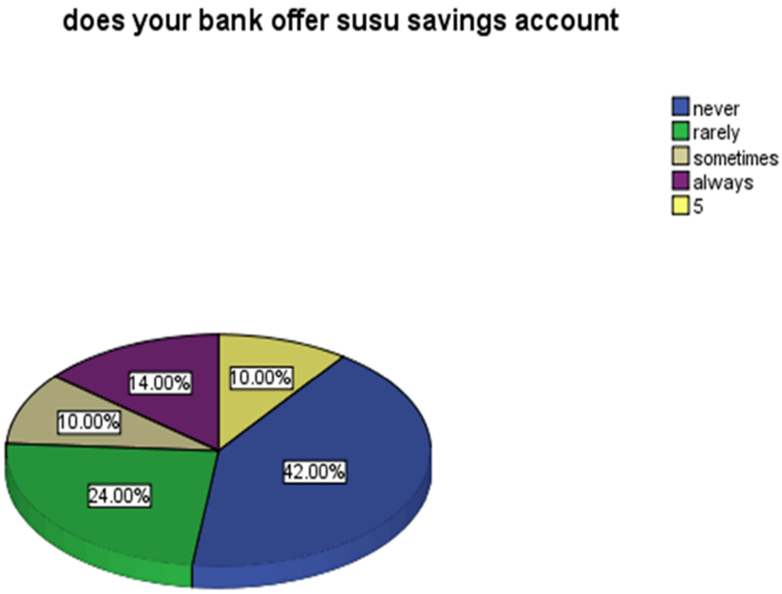

Figure 3. How Often the Banks Accept Susu Savings Account

Figure 3 shows how often the commercial banks in the Kumasi metropolis accept Susu savings account. From the data obtained, 42% of the total banks (GT- banks, Merchant, Ecobank, NIB e.t.c) interviewed said they never accept Susu savings accounts, 24% of the commercial banks sampled rarely accept Susu accounts, 10% of these banks sometimes and frequently accept Susu accounts, and 14% of the commercial banks (UT-banks, e.t.c) always accept Susu account. Although some of the commercial banks now accept Susu accounts but the majority of these have deviated from their target of operation since the majority (66%) of the banks rarely and never accept Susu account.

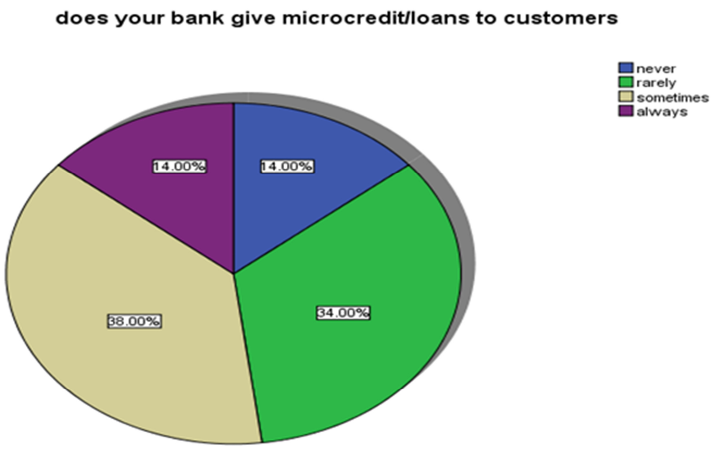

Figure 4. How Often the Banks Give Micro-Credit/ Small Loan To Customers

Figure 4 shows how often the commercial banks now give micro-credit/ small loans to their customers. From the data obtained from the field, 38% of the sampled banks sometimes give small loans/micro-credit to their customers since their target group includes SMEs, individuals and Students but 34% of the banks sampled rarely give small loans/micro-credit to their customers since they do not accept Susu/petty savings account. Also 14% of the banks in the Kumasi metropolis never give micro-credit since such banks exclude petty trader, Susu account e.t.c. and 14% of the total banks (such as UT-bank e.t.c) sampled always give small loans to their clientele whenever they requested.

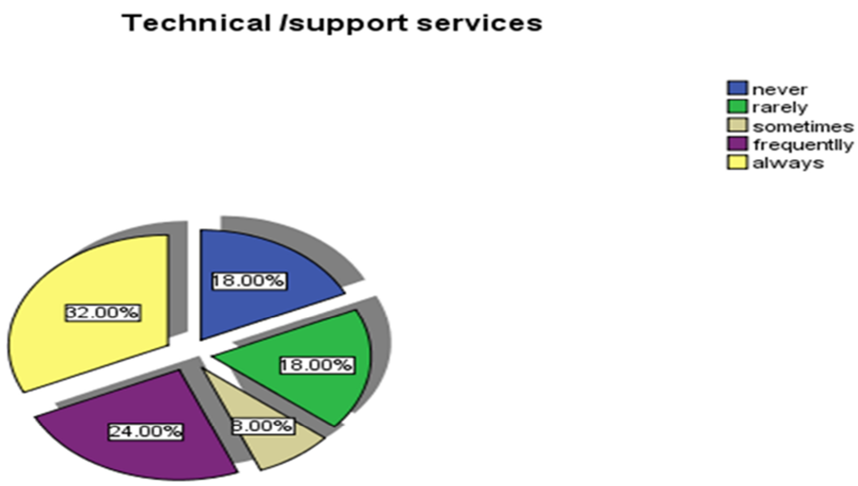

Figure 5. How Often the Banks Give Technical Advice and Support Services to their Customers

Figure 5 shows how often the commercial banks give technical advices/ support services to their customers. About 56% of the total banks interviewed have proven that they frequently and always give technical advice to their customers. Thus the majority of the banks was frequently and always give technical advice to their customers, where 24% of the banks were frequently give technical advice and 32% of the banks always give technical advice to their customers. Also 8% of the banks sampled sometimes give technical advice to their customers, 18% of the banks rarely give technical advice to their customers and sometimes never give technical advice draft to their customers respectively.

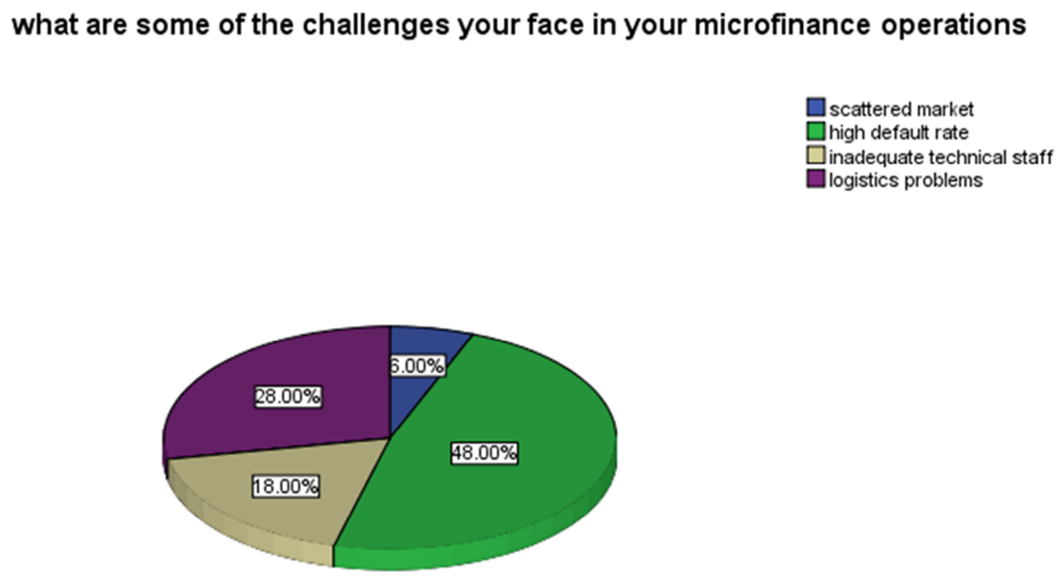

Figure 6. Challenges Commercial Banks Faces In Offering Microfinance Service

Figure 6 shows some of the challenges the commercial banks faces when they tend to provides microfinance services. The most common challenges the banks faces when they tend to provides microfinance services is the high default rate which had 48% of the total banks sampled since microfinance target the neglected groups (lower income group) in the country. The next highest challenges which also seems to be common among the banks was logistics problem which had 28% of the sampled population of the banks, follows by inadequate staffs to manage the affairs of the microfinance services in the commercial banks and the least challenges was the scattered market for the banks which had a percentage of 6%.

4.2 Quantitative Analysis

A positive sign of an estimated coefficient implies that there is the likelihood for the commercial banks to offer microfinance services, given the predictor variable in the model. A negative coefficient reduces the likelihood to offer microfinance services on the financial market to the clients.

TABLE 1. Analysis of the Probit Regression Results

OFFERING MFSs	COEFFICIENTS	STANDARD ERRORS	P>|z|
Bank Location	0.6600025*	.6915017	0.040
Nature of Product	-1.425581**	.534202	0.008
Target Group	3.927161	.4232038	0.353
Profit Motive	0.9297647 ***	715724	0.000
Social Obligation	-0.415381	.124234	0.119
Partners MFIs	-0.4891437*	.7460436	0.012

Legend: * p<0.05; ** p<0.01; ***

4.2.1 Interpretation of Probit Regression Model

Overall tests of significance of the models showed that the model is statistically significant. The Model has LR of 97.61 with ρ- value of 0.0000. The implication is that the variables in the model together have significant impact on commercial banks offering microfinance service on the financial market.

Most of the expected signs of the regression coefficients were met.

The coefficient of β_1 was expected to be positive and this expectation was met and was statistically significant at 0.05 error level. The positive coefficient implies that the probability of the commercial banks to offer microfinance services increases when the bank is located in the rural community. This may be due to the fact that most of the clients in those setting are low income earners and may not be able to access the bank services at the commercial rate; given the fact that the bank has no option with respect to the clientele base, it may be forced to offer microfinance services in the community.

The coefficient of β_2 was expected to be positive, implying that commercial banks will offer microfinance service if the product is tailored to meet the demands of small scale/petty traders and other SMEs (eg Susu savings and micro credits) on the market, since they all involve business activities on the financial market. However, the estimated coefficient in the model was negative and statistically significant at 0.01 error level; this means that the likelihood of the commercial banks to offer microfinance services on the market reduces, if the product tailored is to meet the demands of the petty traders and other small businesses on the market.

The coefficient of β_3 was expected to have a positive sign and this expectation was met but not statistically significant according to the model estimated.

The expected sign of β_4 was met and was significant at 0.001 error level. This implies that the probability of the commercial banks to offer microfinance services on the market increases with profitability levels; if the a particular product is profitable (putting all cost and benefits into perspective), there is the high tendency for the commercial banks to offer it on the market irrespective of the risk level and other difficulties experienced on the market

The coefficient of β_5 was expected to be signed positive and this was met at 0.05 error level. This implies that the likelihood of the commercial banks to offer microfinance services increases if there is some level of partnership between the MFIs and the commercial banks. This is to ensure that these MFIs do run and thrive very well to meet their (both commercial banks and MFIs) objectives on the financial market. This is done by setting a separate unit with the commercial banks to see to the operations of the MFIs in the area of support staff and technical services to the MFIs.

The expected sign of β_6 was met though was not statistically significant. The negative sign implies that the probability of the commercial banks to provide microfinance services reduces, if the service (i.e., microfinance) is to serve as a social obligation to the deprived and marginalized communities who are mostly low income earners. This indicates that commercial banks will always seek to operate as a pure profit oriented business entities in the financial market.

Table 2. Results of the Ordered Probit Regression

VARIABLES	FAIR	GOOD	VERY GOOD
Bank Location	0.0419562	0.0795042**	0.01705 **
	(0.0263311)	(0.0294126)	(0.00563686)
Z-Values	1.59	2.700	3.30
Nature of Product	-0.0315663	0.1485641	0.0514242 **
	(0.0315815)	(0.2214255)	(0.0268161)
Z-Values	-1.00	0.67	2.77
Target Group	-0.3154941	0.1485641**	0.9468477**
	(0.2005562)	(0.0214255)	(0.2931332)
Z-Values	-1.57	2.67	3.23
Profit Motive	0.7821922 (0.4241964)	4.19020512	1.088718**
	1.84	(0.0652)	(0.4448424)
Z-Values		0.03	2.45
Social Obligation	0.1101901	0.0984281	0.0193181 **
	(0.1368614)	(0.157797)	(0.0092981)
Z-Values	0.81	0.62	2.07
Partners MFIs	0.0014046 (0.1616094)	0.086667	0.4314044**
	0.01	(0.1832148)	(0.3107093)
Z-Values		0.47	2.39

Note: Standard errors are presented in parentheses. *, ** and *** denote significance at the 10%, 5% and 1% level, respectively.

Table 2 presented the ordered probit regression result for the extent to which the commercial banks such GCB, UBA, UT-bank, ADB; e.t.c executed the microfinance role in the financial market.

From Table 4.2, with regards to the fair performance of the commercial banks in executing the MFIs product none of the explanatory variables was significant or relevant to the model at 5% significance level.

In line with the good performance of the commercial banks in executing the role of MFIs, almost all the variables were not statistically significant except the bank locations and the target groups which showed a positive significant impact on the good performance model at 5% significance level. The reason was that, Microfinance institutions were known to be situated at the rural areas and less the developed districts, but now most commercial banks have taken the lead to most less developed district and rural areas a typical examples of such banks includes the Ghana commercial banks (GCB), Fidelity banks e.t.c.

Also in line with the target groups, it showed a positive significant impact on the good performance model. The reason is that, commercial banks were known serve cooperate bodies, organizations and institution and excluded the SMEs, individuals, students. The microfinance institution were known serve the neglected groups but now the commercial banks such Ecobank, GCB, UBA e.t.c have extended their services to the poor, individuals, students and others.

Ultimately, the very good performance model for the commercial banks in the executing of the MFIs duties was statistically significant at 5% significance level. In the model all the explanatory variables were statistically significant. This implies the commercial banks did very well or good in executing the role of MFIs in Ghana but not excellent so there is a little room for improvement to excellently perform the role of the MFIs.

For instance in relation to the assessment of the commercial banks towards their social obligation role was very good. The reason attached to the ranked was that some of the commercial banks are located to some rural or less developed districts in order to bring infrastructural development such as good roads, pipe –borne water, building of schools e.t.c. and above all bring growth to some communities. For instance, Bank of Africa Ghana Limited (BOA) as part of its Corporate Social Responsibility (CSR) donated some items to the Kumasi Metropolitan Assembly (KMA) to support KMA's sanitation program in Sokoban, the Wood Village of Kumasi.

Also from the results in the Table 4.2, the commercial banks did very well or good in executing the role of the MFIs based on the respondents opinions. The partner with the MFIs variable was also statistically significant at 5% significance level and exhibited a positive significance impact on the very good performance model. The reason was based on the data obtained from the field, which reveals that 66% of the banks were in partnership with the microfinance institutions where as 34% of the commercial banks operates separately from the microfinance institution and has no link with the MFIs. The following banks matches with the following microfinance institution and serves as a banker to them. Allot microfinance and Fidelity bank, UT-bank and UT-insurance, e.t.c.

The study also revealed that door-to-do banking services are offered by both commercial banks and Microfinance institution; however, while the MFIs may be operation "Susu" savings account and giving out microcredit to individuals, the commercial banks do the door-to-door banking by promoting /marketing their products available to these individuals on the market. Again, the commercial banks will always offer technical and other support services to the MFIs, should there be any form of partnership between them, this will ensure successful operations of the business and help achieve the corporate objectives of both enterprises on the market. In addition , high operational cost, scattered market and high default rate of small businesses in the microfinance sector are major deterrents to commercial banks in their quest to offer microfinance services, no matter how lucrative the business or sector may be.

5.0 Recommendations

This study strongly recommends that all commercial banks offering microfinance services must make sure that credit facilities is made available to the customer on time; this will reduce the cost of transaction to both customers and the bank. Again, receiving credit facility on time will reduce the default rate of customers as the likelihood of misappropriating (eg, on personal or social activities) the fund reduces.

Commercial banks must not go to "sleep" after making their credit facilities available to their customers in the microfinance service, the technical and other support services to their customers must be intensified, to make sure that the fund is applied appropriately, that is in line with corporate objective of both the business entity and commercial bank.

The credit worthiness of customers must be assessed based on pure business considerations and not on family and friend basis of assessment- nepotism and favouritism must be totally avoided in an attempt to offer microfinance services on the market, this will reduce the default rate and improve the bank's credibility on the financial market; customers must be made aware that it the responsibility of both parties to seek to the success of their businesses on the market and so all parties must awake.

It is prudent for all commercial banks intending to go to the microfinance market to partner with the MFIs, since they have the already established structures in place, the clientele base and the technical experience on the market, this will help to reduce the operational cost of business and improve the profit level of both enterprises on the market.

Finally, there must be a strict monitoring and evaluation of the central bank over the financial activities of both MFIs and commercial bank on the market, this will help to avoid fraudulent activities of these money lending and deposit taking institution which can create inflationary problems in the economy- as said by Milton Friedman, "that inflation is always and everywhere a monetary phenomenon"

6.0 Conclusion

This survey revealed that commercial banks go out of their various banking halls to the household on the market often times to promote/market their products available in the banks and not necessarily offer microfinance services to petty traders and other small business units.

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