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To regulate or not? Microfinance growth and collapse in Ghana

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Abstract: *Regulating microfinance is an art of balance between protecting depositors and enabling financial inclusion. Experimentation with microfinance in the late 20th century fostered innovative approaches to financial inclusion of low-income populations around the world. Ghana was a pioneer in regulations that enabled microfinance in some types of licensed institutions, while tolerating other forms. In the early 21st century, for-profit microfinance took off in ways not intended by early promoters. This review paper analyses the consequences of waiting too long to rein in proliferating profit-oriented microfinance companies and failing to build capacity for regulation, resulting in lost deposits, public mistrust, and a painful delicensing exercise. It also draws on some recent empirical research to indicate implications for public perception and key success factors, leading to a recommendation that regulation be accompanied by measures to build capacity for successful transformation and supervision of microfinance institutions for both financial inclusion and sustainability.*

Keywords: microfinance, regulation, capacity-building, licensing, micro and small enterprises

Introduction

Microfinance: to regulate or not to regulate – that is *not* the question. The critical questions are more about timing and balance between enabling innovation and protecting depositors. Ghana was an early leader in regulations that enabled microfinance within the formal financial system, but more recently suffered from failures due to delayed imposition of licensing on a portion of the microfinance sector. Christen and Rosenberg (2000) had argued for regulatory forbearance to give microfinance institutions (MFIs) time to innovate and become sufficiently profitable and capable of complying with prudential regulatory requirements; but they also recognized that 'microfinance is unlikely to achieve anything like its potential unless it can be done in licensed environments. Therefore prudential regulation and supervision of microfinance is a topic that will unquestionably need to be addressed'. They did not, however, anticipate rapid expansion of

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purely profit-oriented microfinance entities that would put deposits at risk while regulators were forbearing. Although Ghana was a pioneer in creating licensing categories amenable to microfinance, it waited too long to restrict entry of weak and sometimes unscrupulous entities, and failed to adequately prepare both institutions and regulators for licensing and regulation of MFIs. This article recounts the unfortunate consequences for both financial stability and public perceptions of microfinance emanating from Ghana's delay in fully regulating microfinance. It suggests how countries might better build capacity for timely introduction of licensing requirements.

After a brief review of literature on key issues of regulating microfinance, the article reviews the evolution of Ghana's microfinance industry in the early 21st century under an accommodative regulatory structure. It then focuses on the Guidelines for MFIs introduced by the Bank of Ghana (BoG) in 2011 and the ensuing struggle to rein in the proliferation of profit-oriented businesses operating – and collapsing – under the rubric of 'microfinance'. The implications for public perceptions of microfinance are then illustrated using data from a sample survey of 450 clients and non-clients of MFIs. To help inform recommendations to address some of the problems of regulatory compliance that arose, data from a sample survey of 106 senior managers of MFIs are used to analyse key factors associated with success in complying with regulations. This serves as a basis for a concluding section recommending that capacity-building programmes be instituted prior to, or at least as part of measures to regulate MFIs.

Literature review: balancing microfinance regulation and innovation

Modern microfinance may be defined as a set of innovative methodologies for making affordable financial services available to the 'non-banked' (or financially excluded) population, with a dual bottom line: that is, a social mission as well as a financial sustainability objective, seeking both poverty alleviation and financial self-sufficiency. Much of the development of modern microfinance in the 1970s and 1980s emphasized 'an integrated package of credit and training with the goal of enterprise development … financed by donors and governments' (Otero and Rhyne, 1994: 11). Protecting depositors was not at issue at that time, because funding was external. But promoters of microfinance as a development and financial inclusion strategy recognized that integration into the financial system would be necessary for maximum outreach and impact. Poor people need to save as well as borrow, and only licensed financial institutions would be able to mobilize investment and savings to the extent required. The 'financial systems approach' argued that lending to microenterprises on a large scale 'cannot be accomplished through subsidies from grants', but requires specialized, self-sufficient financial institutions (Otero and Rhyne, 1994: 2). This in turn requires that such microfinance institutions (MFIs) be licensed and regulated in order to ensure their ability to repay depositors and to protect the financial system as a whole (Pouchous, 2012; CGAP, 2012). Hence many promoters and practitioners encouraged modification of financial laws and regulations to accommodate MFIs and ensure their sustainability (e.g. microfinance NGOs in Uganda; Goodwin-Groen et al., 2004).

On the other hand, there was also a concern that a 'rush to regulate' microfinance could stifle innovation by practitioners of this newly emerging approach to financial services for those previously excluded, and could be constrained in most countries by the lack of MFIs able to mobilize sufficient capital and to sustain themselves without subsidies (in order to meet licensing requirements), as well as by the lack of understanding of microfinance by regulatory authorities and the high costs of supervising relatively small financial institutions (Christen and Rosenberg, 2000; CGAP, 2012). In particular, it was argued that there was no rush to regulate credit-only MFIs (such as NGOs) that lent out of donated funds and were not mobilizing deposits from the public.

Rahman and Luo (2012: 1031) see regulating microfinance as a matter of balancing 'the cost of regulation, social performance, and the effectiveness of regulations'. They note that Bangladesh adopted a range of regulatory stances and mechanisms intended to allow microfinance to flourish by establishing relevant standards for different categories without overly restrictive regulation. An NGO Affairs Bureau was established in 1991 to oversee the rapidly expanding NGO-microfinance institutions, which were eventually brought under the Microfinance Regulatory Authority in 2006, in particular to ensure transparency and accountability in the substantial inflows of external resources. Although Grameen Bank was established legislatively as a bank, it is not directly regulated by the central bank, and indeed has 'no ongoing capital adequacy or liquidity ratio requirements' (Rahman and Luo, 2012: 1025).

In the 2000s, a growing number of countries introduced legislation and regulations that incorporated microfinance into the regulated financial system (Staschen, 2003). There is considerable literature on the approaches to and experience with microfinance regulation in various countries (Staschen, 2003; Steel and Andah, 2008; Pouchous, 2012; Riquet and Poursat, 2013; and a series of *Essays on Regulation and Supervision* funded by CGAP; Andah, 2005). The main concern of MFI practitioners in 2009 was that the pressure for financial sustainability engendered by regulation and mobilization of investors would lead to unrealizable financial performance expectations and mission drift away from social objectives, hurting the reputation of microfinance as a poverty alleviation tool (Lascelles and Mendelson, 2009). There was some evidence that premature licensing of weak MFIs could lead to problems. For example, by 2011 in the West and Central African Monetary Union, 31 mostly large MFIs, accounting for about 9 per cent of all MFI clients (out of 1,500 licensed, mostly small savings and credit cooperatives) had to be liquidated or placed under temporary government administration because of insolvency or other problems (Riquet and Poursat, 2013).

The question arising from the counsel not to 'rush to regulate', which this article investigates, is: what are the consequences of delaying the introduction of licensing requirements for MFIs? In Russia, it was noted that the rise of 'so-called "micro-lending" companies (who look much more like payday lenders or loan sharks)' charging exorbitant interest rates 'gave rise to a wave of indignation on the part of the public, government, mass media and the responsible microfinance industry', casting a shadow over the latter (Mamuta, 2012). A similar situation had occurred in South Africa (Bateman, 2014). Although these cases involve credit-only MFIs, for which prudential regulation was considered less relevant, the failure to regulate even their conduct may open the door for behaviours that undermine the principles and reputation of microfinance as a tool for financial inclusion and poverty alleviation. This article investigates how the failure to prevent the rise of such purely profit-oriented operations under the guise of 'microcredit' undermined Ghana's otherwise progressive approach to regulating microfinance.

Evolution of Ghana's microfinance industry

Precursors of modern microfinance have a long tradition in Ghana (Aryeetey, 1994). Savings and credit groups with rotating payouts, as well as individual savings collectors, are known as *susu* in West Africa (and in the West Indies, indicating that they predated the slave trade; Maynard, 1996). A key source of loans for the predominantly unbanked population was recognized in the Money Lenders Ordinance of 1957 (which assigned regulatory responsibility to the police). The ground was fertile for introduction of microfinance as a policy instrument and for establishment and regulation of specialized MFIs.

Adaptive regulatory structure

Regulation of financial institutions in Ghana has been reactive and adaptive, responding to gaps or crises in ways that have enabled different types of institutions serving different market niches to emerge over time (Steel and Andah, 2008; Popovich and Steel, 2016). Legislation in 1968 established a self-regulatory structure for Credit Unions, which were introduced to Ghana in the 1950s. In 1976 the Bank of Ghana (BoG) issued regulations permitting locally owned rural banks to be established with lower minimum capital and other requirements than commercial banks. The Financial Institutions (Non-Banking) Act 1993 likewise permitted savings and loan companies (S&Ls) to undertake certain banking operations with relatively low minimum capital. When microfinance was promoted in the 1990s and subsequently as a strategy for poverty reduction and financial inclusion, it could operate through these licensed financial institutions, as well as through non-regulated non-governmental organizations (NGOs) and informal savings and credit groups. In contrast, countries such as Uganda and Kenya lacked alternatives to commercial banks and had to introduce special legislation in the 2000s to enable MFIs to become licensed (and hence be able to take savings legally).

Nevertheless, BoG also followed the reasonable dictum of not attempting to regulate what they could not effectively supervise. In the lead-up to the Non-Bank Financial Institutions (NBFI) Law, BoG rejected licensing of *susu* collectors – who collect daily savings from clients to return the accumulated lump sum at the end of the month, for a small fee (Aryeetey, 1994). Self-regulation by Susu Collectors Associations to improve quality and reputation from the bottom up was considered preferable to top-down restriction of entry. And BoG declined to exercise its licensing authority over Credit Unions under the NBFI Law, leaving supervision to self-regulation by the Ghana Co-operative Credit Unions Association (CUA), in collaboration with the Department of Co-operatives (to be replaced by a Co-operative Credit Unions Supervisory Agency that would give BoG indirect supervisory oversight; Ghana MoF, 2015).

Emergence of modern microfinance

Modern microfinance was first introduced to Ghana in the early 1980s by Women's World Banking. In 1994 Women's World Banking Ghana (WWBG) became the first NGO in Africa to transform into a licensed financial institution, as an S&L under the 1993 NBFI Act (Steel and Andah, 2008: 200). Other organizations and investors targeting micro and small enterprises (MSEs) subsequently also used S&Ls as a vehicle.

Other NGOs experimented with microfinance methodologies, including CARE, TechnoServe, and Freedom from Hunger (FFH), leading to establishment of the Ghana Microfinance Institutions Network in 1998 (GHAMFIN, 2013). FFH established partnerships with rural and community banks (RCBs; including more urban versions of the original community-based rural banks) in the 1990s, providing seed funds and training for staff in microfinance methodologies, which the RCBs could then take over. RCBs soon found FFH's Credit (and Savings) with Education model to be both profitable and effective in reaching new clients in villages, and RCBs led the rapid growth of microfinance in Ghana in the early 2000s (Figure 1). Thus, Ghana can be considered as an early adopter in including and expanding microfinance within regulated financial institutions (RCBs and S&Ls).

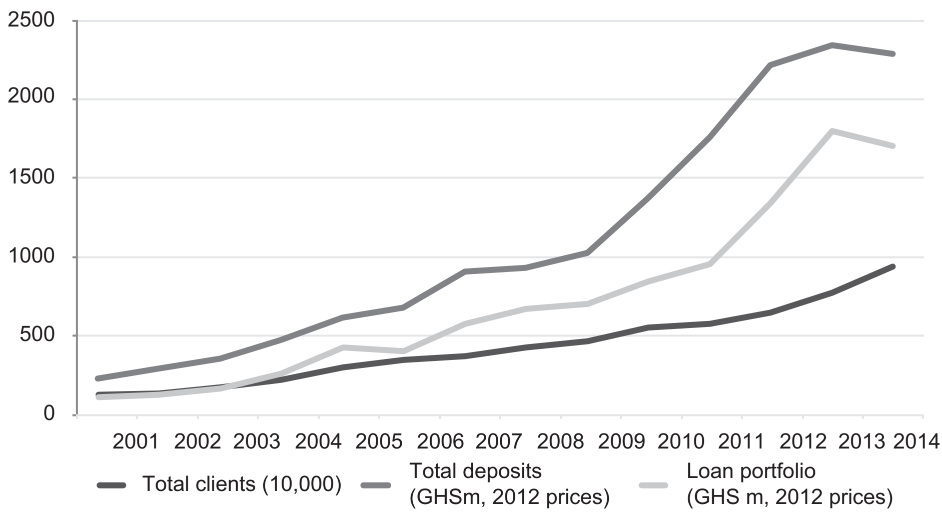

Figure 1 Total MFI clients, deposits, and loans 2001–14 (2012 prices)
Note: 'Total clients' consists of FNGO borrowers, CU members, and savings accounts in all other categories.
Source: GHAMFIN (2014) data (updated to 2014; subsequent data not available).

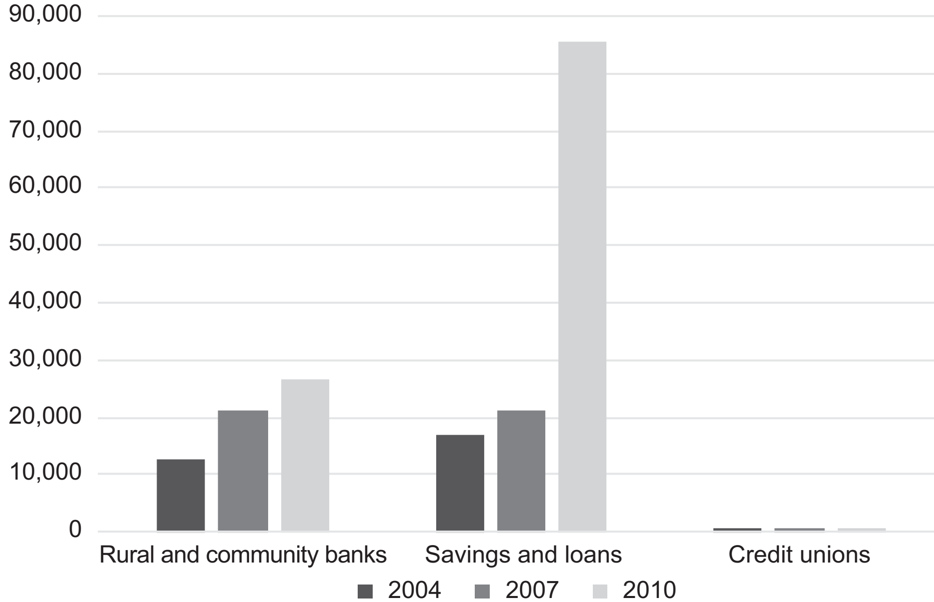

Figure 2 Growth in RCBs, S&Ls, and credit unions, 2004–10
Source: GHAMFIN, 2013: Figure 2.5

Growth in clients lessened somewhat from 23 per cent per annum over 2001–05 to 13 per cent over 2005–10 (GHAMFIN, 2013: Fig 2.4), but on a substantially enlarged base – representing significant penetration of microfinance methodologies across the country. RCBs used microfinance to double their average number of clients from 2004 to 2010, while growth in urban and peri-urban areas was driven largely by S&Ls, which attracted both new investors and NGO transformations in the 2000s with micro and small enterprises as their primary target market (Figure 2). By 2010 MFIs were reaching some 5.4 million clients – over a fifth of the population.

Microfinance as a strategy for poverty reduction and financial inclusion was recognized and supported by the Government of Ghana (GoG) and its development partners. GoG facilitated consultative processes with stakeholders in 1998–9 and 2006–7 to prepare a national microfinance policy (Republic of Ghana, 2007). In both cases, formal adoption by Cabinet stalled in the process of a national election and change of government. Support for micro and rural finance was provided through a number of government and bilateral and multilateral donor projects. Key funders included the World Bank, International Fund for Agricultural Development, Danida, GIZ, Agence Française de Développement, and USAID.

The rapid growth in awareness of and support for microfinance during the first decade of the 2000s presented an opportunity for businesses seeking to mobilize funds. Both private businesses and newly established '*susu* companies' took advantage of the tradition of making daily deposits with a *susu* collector to offer loans of double or even triple the amount accumulated. Other 'microfinance' and 'financial services' companies offered people high returns on their 'investments' – though these often turned out (whether intentionally or not) to be pyramid schemes, in which earlier 'investors' were paid out of savings mobilized from new ones. Such pyramid or Ponzi schemes go back at least as far as the aptly named 'Pyram' in 1993 (Dogbevi, 2017). More recent iterations include MMM and Menzgold. Even if BoG had attempted to persuade the Registrar-General to restrict financial activities from being registered as businesses, many businesses registered for other purposes adopted these strategies as a side activity. These unregulated businesses taking savings from the public (in violation of the Financial Institutions Act) were proliferating far faster than the RCBs and S&Ls (licensed by BoG), as well as the credit unions, individual *susu* collectors, and financial NGOs (FNGOs) that were self-regulated by their associations or were members of GHAMFIN. Unlike modern MFIs as discussed in the literature, their exclusive focus on profits and mobilizing funds lacked both the social/outreach objective of the 'dual bottom line' and the prudential orientation needed for a sustainable, 'financial systems approach'.

Imposition of microfinance guidelines

BoG's stance of regulatory forbearance to avoid regulating what was difficult to supervise made it reluctant to try to intervene directly. In the absence of information, BoG was slow to appreciate the extent of the problem arising from the proliferation of '*susu* companies' and other private for-profit businesses using 'microfinance' and other names to attract funds from the public. Unlike financial institutions that are licensed to take savings, these companies generally lacked their own capital, raising deposits from the public often under the guise of 'investments' – essentially term deposits, with a promise of either a high monthly rate of return or a loan of two-to-three times the amount saved. BoG's initial reaction in the 2000s was to tell *susu* companies to join the Ghana Cooperative Susu Collector's Association (GCSCA). But not only did the Association lack the power to sanction such businesses, it regarded them as unfair competition to individual *susu* collectors by offering loans – whereas individual Association members were expected to deposit each day's collection with a bank for safekeeping until the end of the month; that is, not intermediating the funds.

A growing number of these *susu*/microfinance businesses collapsed or were unable to return clients' savings, as a consequence of their limited capital, the pyramidal nature of offering loans as a multiple of clients' deposits, and their lack of financial management skills. Unaware that they had been dealing with unlicensed, indeed illegal operations, clients often blamed BoG. Nevertheless, in revising the Non-Bank Financial Institutions (NBFI) Act in 2008, BoG explicitly exempted 'operators of micro finance services with risk assets that are not more than the amounts prescribed by the Bank of Ghana' (Republic of Ghana, 2008). At that time, approximately 100 *susu* companies had joined GCSCA – perhaps a quarter of microfinance-related companies then operating.

In 2010 the Ministry of Finance and Economic Planning undertook a study and held a stakeholder workshop on the situation, leading to BoG issuing 'Operating

Rules and Guidelines for Microfinance Institutions' in 2011 (BoG, 2011). These Guidelines implemented provisions of the NBFI Act 2008 and the Banking Act 2004 by articulating four tiers of MFIs with different degrees of formal licensing and supervision:

1. *Tier 1:* Deposit-taking MFIs regulated under the Banking Act and already being licensed and supervised by BoG: **RCBs** and **S&Ls**.
2. *Tier 2:* Deposit-taking MFIs regulated under the Non-Bank Financial Institutions Act:
   - microfinance companies (**MFCs**); supervised directly by BoG;
   - **credit unions**: to be regulated separately under a new legislative instrument.
3. *Tier 3:* Non-deposit-taking MFIs: **incorporated money lenders** (now called microcredit companies; **MCCs**) and **FNGOs**. For these, associations were asked to take the lead in monitoring and reporting on their subsectors.
4. *Tier 4:* Others, specifically, **individual *susu* collectors** and **money lenders**, who were expected to join and report to their respective apex associations, which in turn would inform BoG. (Self-help groups such as village savings and loan associations and rotating savings and credit associations were not mentioned, and to date no attempt has been made to regulate them.)

BoG required companies in Tiers 2 and 3 to include 'Microfinance' or 'Microcredit' (the revised term for money lenders, upon request from their association) in their names. In so doing, it institutionalized 'microfinance' as a for-profit activity in Ghana, not necessarily having a social mission or 'dual bottom line'. Indeed, money lenders are now officially considered part of microfinance/microcredit – regularizing what is traditionally thought of as an exploitative segment of the financial market, albeit meeting needs of the financially excluded. While BoG was motivated to protect 'microfinance' as a financial methodology, the consequence is that the term in practice became associated in the Ghanaian public's mind as much with profit-seeking and exploitatively high interest rates as with the social mission to reduce poverty.

The struggle to license

Introduction of the Microfinance Guidelines was not accompanied by a clear strategy for implementation, let alone preparing both MFIs and regulators. Although the original intention had been to start with licensing existing MFIs, there was no roster of them, and applications were accepted from new companies seeking to license MFIs, as well as those already existing. The eight staff (increased to 12, and subsequently to 25) in the BoG Supervision Department assigned to the task could not cope with the more than 1,000 applications received – largely without the data needed to make a proper assessment.

By the end of 2012, only 90 MFIs had been licensed (Table 1) – but this did not stop hundreds of applicants from continuing to operate. In the absence of adequate staff and data, BoG had to take a stance of broadly licensing all existing MFIs to bring them under the regulatory umbrella, and then trying to sort them out. (The initial licenses were treated as provisional approvals, subject to annual renewal.)

Table 1 Licenses issued to MFIs, 2012–17

	2012	*2013*	*2014*	*2015*	*2016*	*2017*	*Total*
MFC	77	213	140	38	14	2	484
MCC	11	27	24	5	4	–1	70
FNGO	2	7	2	0	0	1	12
Total	90	247	166	43	18	2	
Cumulative		**337**	**503**	**546**	**564**	**566**	**566**

Note: Includes some MFIs that may have ceased operations after licences were issued. Figures for 2014–17 are adjusted for consistency with annual report totals. Licensing was suspended in 2016 'to give greater supervisory attention to the existing licensed institutions' (BoG, 2016: 21).
Source: BoG *Annual Reports*, 2013–2019, and website (https://www.bog.gov.gh/supervision-regulation/all-institutions/).

Only in 2013 (two years after issuing the Microfinance Guidelines), did BoG set up a separate Other Financial Institutions Supervision Department (OFISD) to regulate and supervise all the various tiers of MFIs, as well as foreign exchange bureaus (initially with 75 staff, increasing to 123) (BoG, 2013). In August 2013 BoG also raised the minimum capital (to GHS500,000 (≈USD230,000) for Tier 2 deposit-taking MFIs and GHS300,000 (≈USD125,000) for Tier 3 non-deposit-taking MFIs – a fivefold increase) and tightened liquidity requirements.

Lack of readiness for regulation

Processing of licence applications soon 'revealed severe weaknesses in many of these MFIs in terms of their accounting, management and information systems (MIS), and capabilities' (Republic of Ghana, 2012: 5). Because most of these institutions had been outside the type of microfinance being promoted by both government and donor programmes, many saw microfinance more as a means of mobilizing funds for small-scale trading activities than as a financial institution requiring specialized accounting. They had not received any prior training or logistical support (e.g. computers and MIS), and many lacked basic understanding of how to operate a financial institution. At the time, subsidized training in microfinance was available through the Capacity Building Fund (CBF) of the Government's Rural and Agricultural Finance Programme (RAFiP; supported by the International Fund for Agricultural Development). This was implemented in collaboration with GHAMFIN and its subsectoral apex bodies (for RCBs, S&Ls, credit unions, FNGOs, and *susu* collectors). To facilitate registration and compliance, the new for-profit MFIs quickly formed the Ghana Association of Microfinance Companies (GAMC), which joined GHAMFIN and worked with CBF to design a one-week customized training in the basics of microfinance.

However, a one-week training and the limited resources of the CBF were hardly sufficient to prepare several hundred new MFIs for licensing and regulation (especially prudential requirements). Additional problems hampering their ability to comply with guidelines included weak governance structures, poor management, lack of internal controls, inadequate liquidity and risk management, and lack of computerization and management and information systems.

Difficulties in implementing supervision

Although the pace of processing MFI licence applications picked up in 2013–14, the lack of reporting and inadequate staffing made prudential supervision impossible. With the support of several development partners, training (both domestically and abroad) was gradually provided on various aspects of microfinance operation, reporting, and supervision; and simplified prudential returns and new software were developed.

Many MFIs took advantage of the lax regulatory environment to engage in questionable practices, including rapid growth in the number of branches (seeking new depositors), inter-institutional borrowing, and diversion of funds into other ventures and subsidiaries. DKM Diamond Microfinance Ltd exemplified these problems. It became the largest MFC in Ghana by offering unsustainable returns (40–50 per cent) on 'investments' of 2–3 months, and then diverted much of the proceeds into subsidiaries, as a way of evading prudential regulations (e.g. restrictions on insider lending). With complaints mounting of depositors unable to access their funds, BoG moved in May 2015 to suspend their operations, eventually closing down and de-licensing DKM, affecting some 100,000 clients (Ofori, 2020). It also moved against several 'fun clubs' and other unlicensed companies engaged in unsustainable deposit mobilization activities. In 2016 BoG revoked the provisional licences of some 70 MFCs and MCCs that had failed to provide the necessary documentation. These and other collapses and illiquidity of MFIs adversely affected public perceptions of 'microfinance' and led those whose deposits were locked up to make political demands for restitution.

Despite continued BoG warnings to the public about dealing with unlicensed MFIs and periodic efforts to shut down some clearly fraudulent ones (Myjoyonline, 2018), problems of insolvency continued to grow among licensed as well as unlicensed MFIs, especially MCCs. In 2019, following restructuring of the banking sector and S&Ls as part of cleaning up the financial sector, BoG revoked the licences of 347 MFCs (of which 155 had already ceased operations) and 39 MCCs (Darko, 2019). This left only 180 MFCs, MCCs, and FNGOs – less than a third of those originally licensed (of which 19 are slated for voluntary liquidation; Table 2).

Table 2 Licensed MFIs as at 31 December 2019

Type	
Microfinance companies (MFCs); deposit-taking	137
Micro-credit companies (MCCs); non-deposit-taking	31
Financial NGOs (FNGOs); non-deposit-taking	12
Total	180

Note: 19 MFCs and MCCs reportedly are opting for voluntary liquidation.

Source: BoG, 2020: 22, and website (https://www.bog.gov.gh/supervision-regulation/ofisd/list-of-ofis/).

These measures, however, did not solve the problem of undercapitalization of MFIs – especially the MFCs, which were intermediating deposits. Only 40 of the retained MFCs and MCCs (24 per cent) and 5 of the FNGOs (42 per cent) met the minimum capital requirement at the time. BoG had to extend the 'deadline' for compliance from 2018 to February 2020, and then again to December 2021. Although the raised minimum capital constitutes a barrier to new entry, it has not been sufficient (or applied rigorously enough) to address the weak capitalization and capacities of existing ones.

Nevertheless, in terms of public perception, an important feature of the restructuring exercise was to refund deposits to clients of delicensed MFIs – which accounted for as much as half of the total deposits in MFCs (Mustapha, 2019). The government mobilized GHS 900 m (about USD170 m) to refund deposits to as many as 700,000 clients in defunct MFIs, contingent on providing adequate documentation to the Receiver. As of July 2020, 98 per cent of validated claims for deposits in defunct specialized deposit-taking institutions (including S&Ls as well as MCCs) had been refunded (Awadzi, 2020).

Impact of restructuring on perceptions of MFIs

BoG's revocation of hundreds of licences of closed and insolvent MFIs has substantially cleaned up the sector from a *financial* perspective. The question is whether this has improved the public's perception of MFIs, which had eroded due to collapses of MFIs and loss of deposits, both in the decade prior to introduction of the Microfinance Guidelines and continuing during the eight years that BoG struggled to supervise the many MFIs it had initially licensed. Some insight into perceptions of MFIs before and after the delicensing exercise can be gained from a survey that was conducted in 2020 of 450 microentrepreneurs – who represent a main target of microfinance (Asante, 2020).

Small businesses in the La Nwantanang-Madina municipality (an urban satellite of Accra with a relatively high concentration of MFIs) were selected in three subsectors: hairdressers/barbers (a service activity requiring apprenticeship); taxis (transport); and food selling (trade). (A focus on clients of MFIs was not feasible because there was no way to identify clients of defunct MFIs nor to identify non-clients who would be socio-economically equivalent.) In the absence of a register of these often informal enterprises, random selection was done by walking down the streets and interviewing every fifth or third (depending on density) business in the selected categories. This ensured that respondents had similar socio-economic characteristics. Interviewees were asked whether they were a client of an existing or defunct MFI, or were never a client, until 150 were interviewed in each of these three categories. Snowball technique had to be used to locate enough respondents who were clients of defunct MFIs.

The restructuring (delicensing) exercise had a strong effect on the perceptions of the respondents on the riskiness of MFIs, with the proportion viewing them as very or somewhat risky falling from 63 to 19 per cent (Table 3). Likewise, confidence in MFIs rose from 57 to 79 per cent. Nevertheless, this improvement in perception did

Table 3 Confidence in and perceived riskiness of MFIs before and after restructuring (percentage of respondents)

Perception of MFIs	*Before*	*After*
Very high or high:		
Riskiness	63.4	19.1
Confidence	57.3	78.7
Willingness to save	45.3	46.2
Low or very low		
Riskiness	36.2	81.2
Confidence	41.8	19.1
Willingness to save	51.5	49.1

Source: Asante, 2020: Figure 4.2(a) and (c)

not affect their expressed willingness to actually save in MFIs (less than half). Using a 5-point Likert scale, the decrease in the mean riskiness score (from 3.3 to 1.8) and the increase in the mean score for confidence (from 3.0 to 4.0) were statistically significant at 0.001 (*t*-test). Among those who had negative perceptions before the restructuring, the impact in improving perception was even stronger: their mean scores went from 4.2 to 1.8 for riskiness; from 1.6 to 3.8 for confidence; and from 1.4 to 2.5 for willingness to save, all statistically significant at 0.001. Unsurprisingly, the improvement in perception was greater for clients who had received compensation for their locked-up deposits than those who had not.

Nonetheless, improvement in perception did not translate into a substantial improvement in people's perceptions of the types of MFIs most affected by restructuring compared to alternative sources of saving. Respondents expressed a preference for saving via mobile money (MoMo) and in commercial banks (Table 4).

Table 4 Willingness to save by type of institutions

Financial institution	*Very confident*	*Somewhat confident*	*Not willing to save there*
Mobile money	86.0	12.9	1.1
Commercial banks	90.2	5.1	4.7
Saving and loan	28.2	46.7	25.1
Credit union	21.8	33.6	44.7
Rural bank	19.8	34.0	46.2
Home	4.7	48.2	46.9
Micro credit company	14.4	28.4	57.1
Microfinance company	3.3	23.1	73.6
Susu	0.0	2.9	96.9

Note: Details may fail to add to 100 per cent because of non-response and rounding.
Source: Asante, 2020: Figure 4.7

The attractiveness of MoMo has been enhanced by the requirement to pay interest on retained balances, as well as by its utility in making payments and transfers. More than half of respondents remained unwilling to save in MFCs and MCCs, and were generally sceptical of RCBs – which initially led the outreach of microfinance, but have experienced some distress and closures under restructuring. Perhaps because many of the collapsed institutions labelled their deposit mobilization programmes as '*susu*', the reputation of *susu* collectors has been completely spoiled – even though risks of saving with individual *susu* collectors are limited if they follow the normal methodology of depositing daily collections in a bank account and refunding deposits on a monthly basis.

The need to build capacity

The Bank of Ghana's inability to effectively regulate MFIs after licensing them in the 2010s is attributable largely to the lack of capacity in those MFIs to comply with reporting requirements and to implement sound financial practices (as well as the failure to restrict entry in the first place). The lesson from Ghana's experience is that effective regulation of MFIs requires substantial capacity-building of both the regulators and the institutions to be regulated – preferably before entry or bringing them under licensing. But capacity-building programmes can be expensive, and nascent and not-for-profit MFIs are unlikely to be able to bear much of the cost. If a government or central bank is considering strengthening the capacities of MFIs to comply with regulatory requirements, it is important to know what skills are most critical.

Data from a survey that was undertaken in 2015 can help to indicate what types of skills and characteristics are associated with perceived success in complying with regulatory requirements (Anani, 2016). The sampling frame for the survey was 208 licensed MFIs in Ghana's Greater Accra region, which accounted for nearly half of those that had submitted returns to BoG as of December 2014. Out of 135 that were randomly selected, about 80 per cent provided responses from 106 senior managers (see Anani, 2016, for further details).

Respondents used a 5-point Likert scale to rate their degree of compliance with regulatory requirements within the SLEMS (Solvency, Liquidity, Earnings, Management, Systems and controls) rating system used by OFISD of BoG. Agreement that compliance was satisfactory ranged from 39 per cent for earnings to 91 per cent for management, with 68 per cent overall (Table 5). For statistical analysis, the management score was used as the dependent variable, because the success of an MFI depends most of all on the quality and efficiency of its management to transform the resources of the company and implement the other aspects (Staschen, 1999; Mercer, 2012).

Based on relevant literature on change management and critical success factors (Nadler and Tushman, 1980; Ganesh and Mehta, 2010; Decker et al., 2012, Ngumbao, 2012; Hawking, 2013; Mbugua, 2014), four key areas were identified: organizational, process, product, and people factors. Using the 5-point Likert scale, respondents indicated the perceived success of their institutions of initially 39 specific factors in

Table 5 Perceived compliance with regulatory requirements

Area of compliance	*Agree that compliance is satisfactory (%)*
Overall	68.2
Management	91.0
Systems and controls	90.6
Liquidity	74.7
Solvency	72.0
Earnings	39.2

Source: Anani, 2016: 132

these four areas, narrowed down to 20 factors that were significantly correlated with the overall performance in complying with regulations (Table 6).

To sort out the relative importance of these 20 factors with respect to successful regulatory compliance, both multiple regression and principal axis factoring (PAF) were applied. Regression analysis identified 10 variables as most significant (at p <0.05), and PAF 11 variables (Table 6). The six most critical factors identified by all three methods are: top management; transparency; user recruitment and meeting client needs; objectives; composition of the board; and funding. The importance of adequate funding for regulatory compliance is expected (though not sufficient to explain success). Surprisingly, however, people factors did not emerge as particularly significant. Whereas capacity-building programmes for MFIs typically focus on training staff, these results suggest it is likely to be more effective to build capacities at the top management and board levels. Although staff development and reducing turnover are important for overall success, the risk that trained staff may more readily be recruited to other financial institutions reinforces the finding that compliance-oriented training may more effectively focus on higher levels.

Process and policy factors such as clearly stating objectives and transparency in operations, as well as effectiveness in recruiting clients, also emerge as key factors for capacity-building programmes. Additional process factors identified as significant by either regression or PAF analysis (but not both) include IT (MIS), record-keeping, and loan processing.

Conclusion and recommendations

Ghana was an early leader in establishing a permissive regulatory environment for microfinance. Rural and community banks and savings and loan companies were early adopters of microfinance methodologies to reach previously excluded populations and micro and small enterprises, and they greatly expanded outreach of financial services to both rural populations and MSEs. Nevertheless, the Bank of Ghana exercised regulatory forbearance with respect to a growing number of businesses seeking deposits under the rubric of ‘microfinance’ in the early 2000s – consistent with the views of some that it was preferable to allow innovation than to rush to regulate.

Table 6 Determinants of successful regulatory compliance: Results of hypothesis testing

Independent factor	*Pearson correlation co-efficient: Accept hypothesis if r > 0.196*	*Regression: Accept hypothesis if p < 0.05*	*Factor matrix with PAF[1]: factor loading is good if > 0.60*
Organizational			
Top management	0.590*	0.001*	0.731*
Composition of board	0.564*	0.004*	0.650*
Funding	0.465*	0.007*	0.606*
Ownership	0.365*	0.893	0.499
Accountability	0.364*	0.973	0.551
Process			
Transparency	0.624*	0.004*	0.825*
Objectives	0.578*	0.005*	0.732*
Record keeping	0.509*	0.057	0.605*
Loan processing	0.501*	0.448	0.667*
Monitoring	0.473*	0.804	0.791*
IT(MIS)	0.433*	0.001*	0.408
Internal audit	0.293*	0.066	0.540
Product			
User recruitment	0.418*	0.003*	0.717*
Pricing	0.328*	0.004*	0.358
Innovation	0.323*	0.963	0.674*
Timeliness	0.262*	0.198	0.330
People factors			
Skilled staff	0.378*	0.319	0.556
Staff development	0.374*	0.015*	0.551
Recruitment	0.368*	0.134	0.608*
Staff turnover	0.270*	0.004*	0.167
Results summary	*20 variables accepted	*10 variables accepted	*11 variables accepted

1 PAF = principal axis factoring

Source: Anani, 2016: Table D.4

This article shows that the consequences of the delay in regulating the entire microfinance sector until 2011 was a tarnishing of the reputation of 'microfinance' as an innovative strategy for financial inclusion and poverty reduction, due to the loss of savings from the growing number of collapses of financial businesses operating in the name of 'microfinance'. By the time BoG intervened to require licensing of all such institutions, the number of applicants and inadequate reporting overwhelmed their capacity to regulate, resulting in continued collapses of now-licensed MFIs.

In 2019 BoG attempted to restructure the sector by revoking the licences of over two-thirds of those it had licensed in 2012–16. This did achieve a substantial improvement of people's perception of the riskiness of MFIs and their confidence in them – but not so much in their willingness to save in MFIs. Indeed, some of the remaining MFIs still are not reporting adequately, and relatively few have met the increased minimum capital requirements (despite repeated postponements of the deadline). Thus, despite the confidence that licensing is intended to convey, MFCs and MCCs are at the bottom of people's list of preferred institutions for saving, with mobile money and commercial banks at the top.

Ghana's struggle to get the newly licensed MFIs to comply with reporting and prudential requirements implies that capacity-building programmes are essential to prepare MFIs for licensing and supervision. The evidence suggests that (from the compliance perspective) it may be more effective to focus on top management, board quality, and process factors such as objectives and transparency, as well as MIS and record-keeping, than on more general staff training. Another lesson is to restrict the use of the term 'microfinance' to distinguish MFIs from purely profit-driven activities. Ghana's microfinance industry now needs a major campaign, first to strengthen reporting and regulatory compliance of the remaining licensed MFIs and, second, to persuade consumers (especially MSEs) that MFIs are safe and suited to their needs.

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