THE EFFECT OF CENTRAL BANK REGULATIONS ON THE PERFORMANCE OF MICROFINANCE INSTITUTIONS. A CASE STUDY OF PRIDE UGANDA

BY

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DECLARATION

I MATINYI VIOLET declare to the best of my knowledge that this report is my original work and it has never been published or submitted for an award of a degree of this university or any other institution of higher learning.

Signature: ....

MATINYI VIOLET

Date: 28th/MAY/2008

APPROVAL

This is to certify that this research work was done under my supervision and it is ready for submission to the university.

Signature: ....

MR. WANDIBA AUGUSTINE

(SUPERVISOR)

Date: ...30th – 05 – 2008. ....

DEDICATION

I dedicate this book to my father; Mr. Mungoma Jude Ted, my mother, Mrs. Mungoma Veronica Seela and my friends..

ACKNOWLEDGEMENT

Often accomplishments require efforts of many people and therefore this work is not an exception to this fact.

First and foremost, I would like to thank God the Almighty. He has done mighty things for me and among the many things are the completion of this degree and the gift of life.

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ABSTRACT

The study sought to examine the regulation of Microfinance Institutions and the performance of these institutions as well. Specifically the study looked at regulation by the Central Bank and looked at client outreach as a performance indicator.

The study further identified ways in which MFIs are regulated by the Central Bank, performance levels of MFIs was established and further established the relationship between regulations performances of MFIs.

The research design used was a descriptive and analytical one which was based on qualitative data advanced by various scholars. Different types of sources of data like research reports, journal articles, and research papers among others were used. Review of Literature was done to identify the discrepancy in the information.

A method of co relational analysis was adopted to establish the relationship between the variables.

The research findings showed that regulation increases outreach of MFIs but also factors like new technology, innovativeness can work as a way of extending financial services nearly to the poor people. The researcher makes conclusion and gives recommendations that can enhance the Central Bank Regulations so that inefficiencies can be reduced or done away with.

CHAPTER ONE

1.0 Introduction

This chapter covers the following areas; Background of the study, statement of the problem, purpose of the study, study objectives, research questions, scope of the study and significance of the study.

1.1 Background to the Study

The concept of microfinance is an old one dating back to the 19th century when for instance Raiffesisen and Schulze Delitzch re-invested the wheel of Micro finance during the hunger years of 1846 and 1847 in German. Micro finance was found to be the most likely means of availing a solution to the worlds most under developed regions. For example in Africa, 70% of the population lives in the rural areas. These areas also have the poorest population (NEPAD, 2002).

Banks in developing countries typically serve not more than 20% of the population leaving the rest with little, if any, access to financial services (Greuning et al, 1998). This meant that the poor were not being provided with loans and savings products that were suited to their financial needs. As a result, Micro finance institutions (MFIs) were introduces (NEPAD, 2002). MFIs have emerged in Burkina Faso, Gambia, Ghana, Malawi, Tanzania and Uganda among other countries (Kalyalya, 2003).

In Uganda, semi formalized Micro finance began emerging as an industry in the early 1990s. Over the last decade, the Micro finance industry has steadily grown, bringing the MFIs existence for over 1500, (The New Vision Monday, 29th August, 2005). These institutions are both informal and formal MFIs have shown remarkable growth since 1994 in terms of outreach, recognitions and specialization. Accountability has been a key to building a strong Micro finance industry ready for regulation and supervision. Effective regulation has tended to follow rather than lead the development of a strong Micro finance industry (Rosenburg, 2000). The timing of MFI regulation came at a time when there was a critical mass of MFIs ready to become licensed as deposit taking institutions. To take deposits safety, MFIs must be profitable enough to cover their costs and at the time of enacting the Micro Finance Deposit Taking Institutions (MDI) Act in 2003, there was a number of MFIs that were profitable enough. The MFI industry in Uganda has emerged since the year 2000 after the collapse of several commercial banks and the increased MFI activity called for the regulation of their activities and this was done through the MDI Act 2003 by BOU.

German Technical Cooperation (GTZ's) close association with the Central Bank to develop a frame work for licensing, regulating and supervising MDIs and the help rendered by donor teams like (USAID's SPEED project in helping build institutional capacity to intermediate clients deposits, were also other success factors. Christen and Rosenburg (2000) share the view that governments regulate MFIs because they are concerned with the weak governance structures and practices of some MFIs, which for instance charge high interest rates. Furthermore, regulation is a means for the state to curb trouble some foreign NGOs or other groups that it would like to control more tightly. In order to strengthen the regulations of MFIs, regulators concern themselves with also regulating the Non-MDIs through studying the governance structure of MFIs in order to avoid abuse.

Despite the efforts of government to significantly step up client's outreach, to enhance ownership and management, and to improve institutional capacity through regulations, the recently decreed MDI Act brings only a few MFIs under the control of the Central Bank leaving many MFIs to continue operating without any statutory or mandatory regulation.

1.2 Statement of the Problem

MFIs are a critical aspect in the development equation of a country especially as far as the poor and the under privileged are concerned must be upheld. In spite of the introduction of MF regulation through the Central Bank, regulation has not achieved the objective of having many of the MFIs turned into MDIs and the performance of MFIs has remained problematic (International Journal of Social Economics, 2004). By far the majority of MFIs are still not subject to government regulations. Little practical experience has been gained and theoretical discussion is still at an early stage (Escchborn, 1999).

Through the Central Bank's consistent performance checks, more MFIs should have grown to become MDIs. However many MFIs have continued to operate without any statutory or mandatory regulation (Christen et al, 1998). Out of over 1500 MFIs in Uganda, only 4 (four); (Uganda Micro Finance Limited, Uganda Finance Trust, Pride Uganda Ltd, Finca Uganda Ltd) have been left to take deposits from the public.

1.3 Purpose of the study

The purpose of the study was to ascertain the relationship between Central Bank regulation and the performance of MFIs.

1.4 Study Objectives

i) To establish the means by which the Central Bank regulates MFIs.

ii) To evaluate the performance of MFIs

iii) To investigate the relationship between central Bank regulation and the performance of MFIs.

1.5 Research Questions

i) How does the Central Bank regulate MFIs?

ii) What is the level of performance of MFIs?

iii) What is the relationship between Central Bank regulations and the performance of MFIs?

1.6 Scope of the Study

The research focused on an in depth study of regulatory by a supervisory body, particularly government, through the Central Bank, of MFIs established between 1990 to 2006. Client –outreach was the basis for measuring performance of MFIs.

1.7 Significance of the Study

i) MFIs and government would use this new information to enable them enhance their level of efficiency.

ii) A mechanism of addressing the consistently problematic operations of MFIs and how to counter these problems.

iii) Regulatory bodies would be provided with an insight into how best they can supervise and regulate MFIs so as to achieve the purpose of regulation.

iv) The study would contribute to the existing body of knowledge about Micro Finance Regulation.

v) Requirement for the partial fulfillment of the award of a BBA degree of Kampala International University.

CHAPTER TWO

LITERATURE REVIEW

2.0 Introduction

This chapter reviews existing and empirical literature from various scholars related to the study. different perspectives are shown as regards the meaning of central Bank regulations and performance of Micro finance Institutions, rationale for regulation, types of regulation, drawbacks, principles of regulation, types of Micro finance, client outreach as a MFI performance indication, as well as the relationships among these issues.

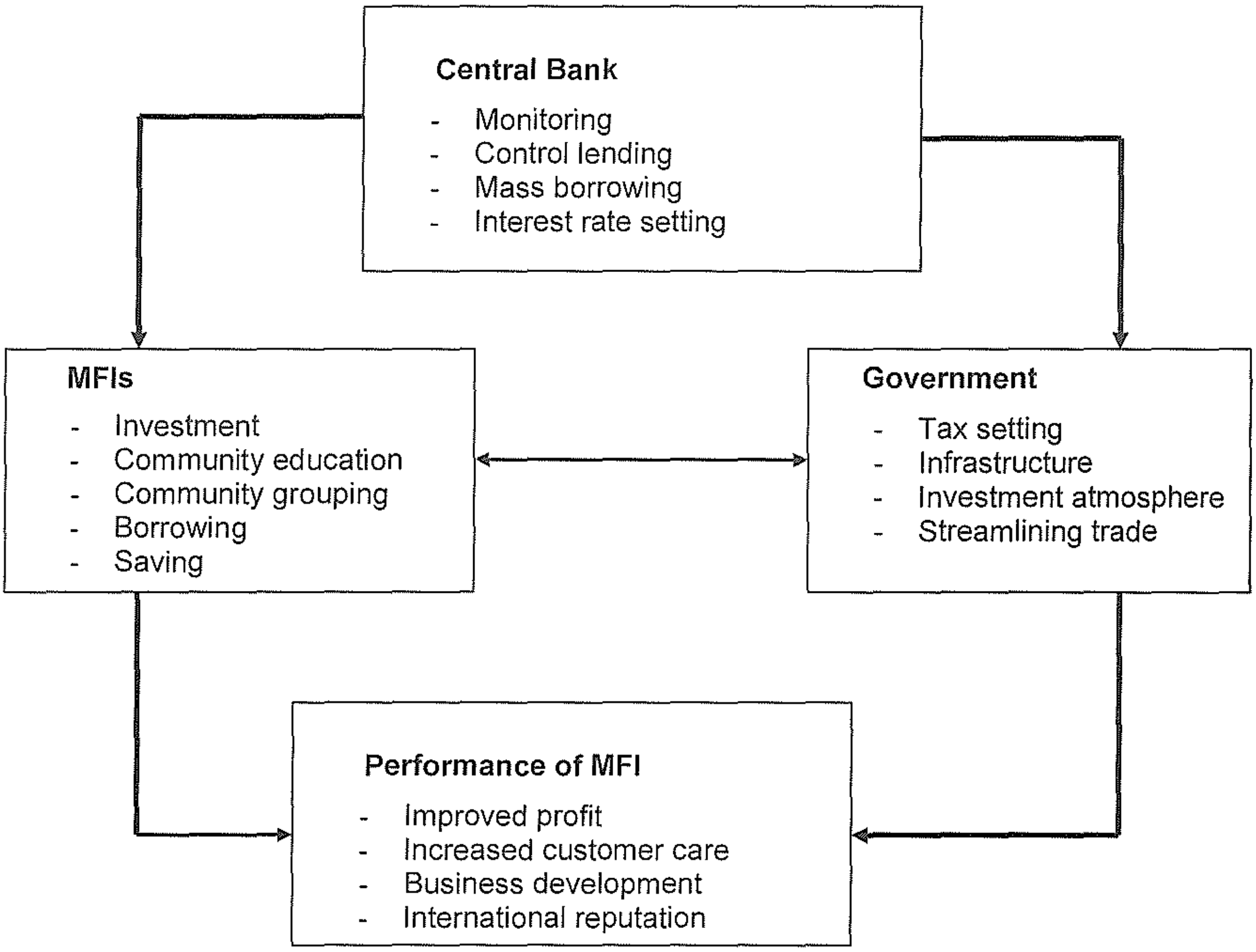
2.1 Theoretical Review

The study was based in the Micro neo classic trade and investment theory put forward by Linda (1964). According to this theory, there are nation wide gains from economic monitor in that is geared to Micro-level business and trade control. The theory supposes that in any national investment undertaking, there must be an independent body to take control of the system to ensure that there is no collusion, exploitation and duplication of effort.

The theory arose from the need of an international body to monitor the behavior of the business community right from the micro concept. Related to that, monitoring unions inculcated a certain amount of discipline among governments' leaders' behaviours. In fact from this understanding, Linda notes that some societies stated joining monetary unions with the knowledge that the binding monitory system, the control of fiscal policies and borrowing were tie hands of politicians.

At national level therefore, the central banks came out as the only channels through which business controls could be enhanced without recourse to inflation duplication and political interference. This theory supports the current study in a view that there is financial undertaking to the tune of micro-finance institution that can run away from the Central Bank controls. The purpose however is not to shrink business but enhance business with maximum customer and the investors' satisfaction.

2.2 Conceptual Framework



From the above conceptual framework, the role of the central bank is practically to monitor the business activities by controlling lending and borrowing. At the same time however, the government is highly involved in regulations through taxation, infrastructure and streamlining the trade networks. All these controls will influence the performance of micro-finance institutions, whose role is basically to make a contribution to individual, community and national development through small scale lending and borrowing plus saving. The conceptual framework justified the reason for the researcher indulging into the study to establish the relationship between Central Bank controls and performance of the MFIs with particular attention to Pride Micro-finance.

2.3.0 Related Literature

2. 3.1 The means by which the Central Bank regulates MFIs

The Consultative Group to Assist the poor (Gap) defines MFI regulation as a set of government rules that apply to Micro finance. The Bank of Uganda policy Statement on MFI regulations adds on (Gap) definition by stating that regulation is a set of clear and fail rulers for financial intermediation. Greuning et al (1998) give two approaches to regulation of MFIs.

i) Internal regulation through governance

ii) External regulation by a supervisory agency

Greuning et. al, (1998) explains that the financial dynamics and risk characteristics of MFIs operations that make them distinct from formal banking institutions brings about a need to adopt a fundamental framework of prudential regulation. CGAP (2004) agrees with Greuning et al (1998) that the supervisory body responsible for commercial bank is best suited to the regulation of MFIs and that this supervisory body in the view of CGAP (2004) is the central bank.

There have been general principles that can be applied to the regulation of Micro finance institutions and Stefan Staschen Escborn gives some of the principles as the following:-

This implies that the regulation must be organized to avoid distortion of competition amongst the financial intermediaries. The aim is have a 'leveled playing field'. However this should not be confused with having the same regulations for all financial institutions. The impact on different types of institutions can differ greatly, thus actually causing competitive distortions; Regulate Bank and nonblank intermediaries differently.

At the level of financial institutions, resources are channeled to their most productive use, **Operational efficiency** (minimizing transactional costs) and **dynamic efficiency** (adaptability to changing environment). The efficiency of the financial institutions is the measure of the efficiency of the regulatory framework. The prime danger of regulating MFIs is restricting their dynamic efficiency, since little practical experience is available at first and the risk of inappropriate regulation is particularly high as a result. As far as possible, the regulatory framework for financial institutions should stipulate a governance structure that is incentive compatible, that is to say that makes full use of the self interest of the individuals (owner, manager, depositor, borrower, among others), to arrive at the desired results.

The regulatory framework for financial institutions must be flexible enough to be able to react to regulatory avoidance, technological innovation, failures of certain regulatory measures among others. This is particularly important in Micro finance, since hardly any experience is available in other countries. Regulation can be seen as an evolutionary process where individual institutional types or only some elements of their ownership and governance structure prevail and others are superseded. One of the great strength of unregulated MFIs till now has been their ability to test innovative products which call for functional instead of institutional regulation. In institutional regulation, there are different regulatory frameworks that prescribe requirements for certain institutional types (for example a banking law alongside cooperatives legislation and a law for a finance companies), but these rarely allow for an easy transition from one category to another.

The MDI Act (2003) states that central Bank shall be responsible for; supervising institutions and their associates or affiliates to ensure that they comply with the provisions of the Act. The MDI Act (2003) adds that the central bank may exercise its regulations through; Analysis of documents supplied to it, inspection of corporate accounting, financial and non financial records prepared by the institution concerned and any other lawful means that the central bank considers more appropriate. Greuning et al (1998) argue that bank supervisors become involved in the external risk management process for MFI regulation because of the interest of the government in the soundness and stability of the banking and financial system for the sake of the economy. Greuning et al (1998) conclude by saying that the regulation is done through licensing and that after issuing licenses, regulatory agencies can then supervise the other operations and activities of regulated institutions. There are a number of factors that need to be regulated under the micro finance regulations.

For an MFI to commence its business there are a number of requirements that it must comply with. These include the following:- This is the minimum amount of money that an investor in the MFI business should possess before commencement of business. This shows whether the company is legally registered under the companies Act or not. This looks at the fitness of the proposed mangers of the institution to run the new institutions in terms of the academic qualification, experience and past trend of dealing in the same type of business. This looks at how the institutions will be owned stipulating how much ownership each of the shareholders will hold.

These are requirements that should be maintained on a daily basis by MFIs. These include; These are requirements that should be submitted to the regulatory body in a country by MFIs periodically. They include weekly returns and capital adequacy rations (CGAP, 2006.

Christen and Rosenburg (2000) and CGAP (2004) give two types of central bank regulation namely; prudential and non prudential regulation and distinguish between them as follows; Prudential regulation- CGAP (2004) states that prudential regulation is used to regulate Micro finance Deposit taking Institutions (MDIs). CGAP (2004) goes on to explain that prudential regulation involves capital adequacy requirements and rules for loan loss provision. Christen and Rosenberg (2000) agree on the requirements for financial structure but add that under prudential regulation, MDIs are required to provide for detailed standards on matters such as accounting practices and policies, adhering to management principles, intensive reporting and onsite inspection of institutions.

The MDI Act (2003) agrees with c Christen and Rosenburg (2000) by stating that the Central Bank is required to visit the premises of the regulated institutions once a year. CGAP (2004) observes that prudential regulation is aimed at preventing unsafe institutions from depositor's money and damaging public confidence in the financial system involves monitoring and protecting the core health of an instruction. CGAP (2004) criticizes prudential regulation as being relatively difficult, intrusive and expensive.

David L. Kalyango (3003) contributes that it is not economically feasible for the central bank to regulate all MFIs due resource constraint and that regulation of all MFIs could stifle innovation and growth of the industry.

Non prudential regulation - CGAP (2004) considers no prudential regulation as the one applicable to MFIs that do not take deposits. Christen and Rosenburg differ a little in their definition of non-prudential regulation and elaborately state that it is regulation that concerns itself with those legal responsibilities and duties that do not involve the regulatory authority taking or responsibility for the soundness of the regulated institutions. However, CGAP (2004) and Christen and Rosenburg (2003) both agree on the requirements for no prudential regulations of MFIs. CGAP (2004) observes that no prudential; regulation focuses on screening out unsuitable owners/mangers. On the issue of ownership, Christen et al (2000) add that MFIs should disclose ownership and control structures. CGAP (2004) points out the requirement for transparency, reporting and disclosure. To this, Christen et al (2000) assert that MFIs are required to report or publish financial statements as well as transparent disclosure of interest rates to customers.

2.3.2 The Performance of MFIs in Uganda

MFIs are faced with incremental costs of adhering to organizational, technical and staff resources to comply with the reporting requirements and supervisory procedures. In addition, there is a question of whether supervisory bodies have the capacity to regulate MFIs. Furthermore, regulatory agencies area likely to impose regulatory structures those are not appropriate to MFIs. There is also a possibility of repression of innovation and flexibility that MFIs enjoy as informal institutions. It has been said that regulation by a government agency is not the ultimate solution to the market inefficiencies in discriminating between sustainable and non sustainable and non viable providers of Micro finance services (Greuning et al, 1998). Regulation of all MFIs by the Central Bank through the supervisory framework is constrained by inadequate resources. (David L. Kalyango, 2004).

Miles,2005 appreciates that since 1992, several Microfinance NGOs have transformed into regulated financial institutions in order to serve more clients, to diversify sources of funding, and to respond to client demand for different types of retain products. Miles adds: "Transformation is only one way for MFIs to achieve increased outreach, diversify funding and respond to client demand for different types of products." Successfully regulation will be a complex and multi-pronged intervention, if it has to successfully contribute to enhancing the provision of financial services to the poor. the challenge of regulation in microfinance requires not only to serve and protect the interest of the poor but also in the overall integration of the services in such a manner that results in increasing the flow pf resources to the poor (Sa-Dhan Newsletter, 2002).

MFIs have a number of services that they offer to their customers who would not have easily accessed them from the mainstream banks. These services are explained below.

A deposit is a specific sum of money taken and held on account by a financial institution as a service provided to its clients. MFIs may take deposits from their customers and pool them up to make a lump some of loanable money to other Micro finance borrowers. Deposit taking is not only useful to the MFI customers but also useful to the MFI in that it acts as a source self financing in addition to other sources like donations among others. A loan is a type of debt that entails the redistribution of financial assets over time, between the lender and the borrower. The borrower initial receives a number of money from the lender, which they pay back, usually but not always in regular installments, to the lender. This service is generally provided at a cost, referred to as interest on the debt. MFIs advance small amounts of loans to their customers so that they meet their domestic needs and investment needs.

Payment and money transfer services: MFIs may offer among other services the payment service where it carries out this responsibility for some of its clients like individual and institutions, meeting standing orders for customers such as power and electricity bills. On the money transfer services, MFIs cooperate with money transfer locations world wide.

Micro insurance: This is a type of insurance that covers insurance risks of poor people that cannot afford the services of the mainstreaming insurance companies. So far the Micro finance Institutions; programs have been focusing on providing savings and credit services only. However a growing number of MFI practitioners and promoters have recognized that providing credit is not enough for the sustainable development of the people. A range of other financial services including insurance and other support services are required to be provided along with savings and credit services. The poor are vulnerable to different types of risks and adopt various strategies to reduce the impact of the losses. Natural disasters, theft and life cycle needs. Formal insurance services are not accessible to the poor because of high premiums and complicated procedures. (Christen and Rosenburg, 1999).

Christen et al (2000) identify three factors that have fueled the growing interest in regulation of Micro finance. Christen et al (2000) argue that NGOs engaged in Micro finance would like to attain regulatory recognition in order to access public deposits and donor credit lines. They further emphasize that MFI practitioners view regulatory recognitions as a reputation enhancing mechanism. Greuning et al. (1998) agree that most countries permit deposit taking from the general public to be carried out only by formally licensed financial institutions. Greuning et. al, (1998) explain that the use of the name 'bank' is restricted only to entities legally organized or licensed as such.

Christen et al (2000) and Greuning et al (1998) both agree that through licensing regulatory agencies could clamp down on troublesome groups that it would like to control more tightly. McGuire et al (1998) observe that in Bangladesh and India, the regulation of MFIs is a non- prudential and in agreement, McGuire et al (1998) offer support for prudential regulation of MFIs because of delays, uncertainties and frustration faced by MFIs due to regulation on non prudential grounds.

In conclusion, regulation for all types of financial institutions, address public policy goals; ensuring the solvency and soundness of financial intermediaries, protecting the stability of the country's payments system, protecting consumers against bank failure, fraud or opportunistic behaviour by management, promoting market efficiency and appropriate functioning of competitive market forces (Sa-Dhan Newsletter, 2000).

MFIs are described as the provision of a broad range of financial services such as deposits, loans, payment services, money transfers and insurance to the poor and low-income households and their farm or no farm micro enterprises (Charitoneko & Campion, 2003). Bamako, (2000) does not differ much when he defines micro finance as the supply of basic financial services to poor and low-income households and their micro-enterprises. An important goal of many, especially Rural Micro finance institutions (RMFIs) is to provide sustainable Micro finance facilities to the poor to facilitate income generation and reduce poverty (Baumann, 2001).

Measures to bring Micro finance services to the people who are underserved by financial institutions are classified as outreach. Outreach can be measured in terms of *breadth* number of clients served and volume of services. (that is to say, total savings on deposit and total outstanding portfolio) or *depth* – the socio-economic level of clients that MFIs reach (CGAP, 2003). Small Enterprises Education and Promotion Network-SEEP (2005), adds that outreach is indicated by the number of clients or accounts that are active at a given point in time and that this indicator is more useful than the cumulative number of loans made or clients served during a period. SEEP (2005) goes on to explain that expanding the number of clients being served is an ultimate goal of almost all MFIs.

IFAD (2002) agrees with SEEP (2005) and adds that most MFIs provide savings and loan facilities through groups. IFAD (2004) further explains that through group outreach, MFIs can avail themselves to groups and their representatives for a number of activities such as the disbursement of individual loans, the collection of individual loans, the collection of individual savings and repayments, peer monitoring and repayment pressure.

The level of MFI outreach: FAO (2002) states that despite the world wide expansion of MFIs in the last two decades, an overwhelming number of people continue to lack access to basic financial services. However, Sa-Dhan

Newsletter (2002) gives a different case for India, where 6the past few years have seen a tremendous progress in terms of outreach and resources involved. Thousands of NGOs and a good number of non Banking Financial Companies in India (NBFCs) have come into existence to cater for the financial needs of the poor not reached by the formal banking systems.

Overall, Africa MFIs are important actors in the financial sector, and they are well positioned to grow and reach the millions of potential clients who currently do not have access to mainstream financial services (Sa-Dhan Newsletter, 2002). Africa MFIs lead MFIs in other global regions in reaching the most savers. More than 70% of reporting MFIs mobilize voluntary deposits, demonstrating the "African exception." unlike MFIs in the rest of the Global regions, African MFIs traditionally have focused on savings services (CGAP, 2003). Outreach numbers also vary by region, as well as MFI type. In Africa, unregulated MFIs tend to be much smaller than their regulated and cooperative counterparts. indeed, unregulated MFIs account for 22% of all reporting MFIs but also only represent 11% of borrowers and, furthermore, 4% of voluntary savers (CGAP, 2003).

Ways of increasing outreach: According to the Uganda Micro Finance Sector Effectiveness Review (2004), many stakeholders in Uganda believe that supporting a small number of large, efficient, and sustainable MFIs (for example MDIs) is the best way to increase outreach and ensure that quality services will be available on a large scale in rural regions. The Review goes on to say that with this approach, a small number of large institutions would expand into rural areas and be financed through local deposits and commercial financing.

However, within the Uganda sector Effectiveness Review (2004) is a contradiction; other stakeholders believe that the large institutions will take too long to reach rural areas and that support should be given to the many smaller MFIs already located in rural areas. These stakeholders believe that the small institution have a true desire to innovate and find ways to reach agricultural and very poor communities and offer the best solution for rural Microfinance. The contenders of their approach believe that the higher transaction costs of reaching rural clients may make sustainability unattainable and justify using subsidies.

Technological innovations, product refinements, and on going efforts to strengthen the capacity of African MFIs are needed to reduce costs, increase outreach, and boost overall profitability (Sa-Dhan Newsletter, 2002) CGAP (2003) reports that some MDIs achieve deeper outreach by targeting the client groups that are most vulnerable such as women and /or people with very low incomes. FAO (2002) agrees and says that by targeting poorer households through women, it becomes more effective as they ensure higher repayment rates than men. Part of the success of the Grameen Bank of Bangladesh has been attributed mainly to its concentration on lending to women groups (Kalyalya, 2003).

2.3.3 The relationship between central Bank regulation and the performance of MFIs

The Sa-Dhan newsletter (2002) continues that exercise of regulation involves addressing a variety of issues which include a favorable policy and legal environment, operational and performance standards, innovations and capacity building of the sector for sustainable provisions of financial services to the poor among other issues.

The outreach to savings by clients of regulated and cooperative MFIs underscores the importance of savings products in Africa. Proportionally smaller than their counterparts, regulated MFIs reach fewer savers because the regulations in many countries either limit or prohibit the mobilization of savings by the unregulated institutions (CGAP, 2003). A survey carried out by CGAP (2003) revealed that regulated MFIs increased most in numbers of borrowers and savers. On an analyzed basis, the number of borrowers and savers grew 51% and 61%, respectively, for regulated MFIs, compared to 22% and 30%, respectively for unregulated MFIs, and 13% and 18%, respectively for cooperatives. Unregulated MFIs serve the highest percentage of women borrowers. Women represent over 50% of borrowers from African cooperatives, 63% of borrowers from regulated MFIs, and 69% of borrowers from unregulated MFIs. One explanation for this variation is that unregulated MFIs include NGOs and projects which target women (CGAP).

In a nutshell, unregulated MFIs mange lower loan and savings balances than other types of MFIs in both absolute and relative terms. Also unregulated MFIs and projects in the sample are often welfare–oriented and target vulnerable clients such as women, people with very low incomes (CGAP, 2003). "In conclusion, while unregulated MFIs are reaching poorer clients, they have higher interest costs and smaller operations volume; these institutions will need to scale up, transform, or merge with other institutions to achieve levels of efficiency that can guarantee their continued operation" (CGAP, 2003).

Meagher (2002) says that in designing a regulatory framework for MFIs, the market has to be defined in terms of how MFIs fit into tiered financial services structures, how Micro finance is in fact defined for this purpose and determining which kinds of institutions are regulated and by whom. CGAP (2004) in turn states that to take deposits safely, MFIs must be profitable enough to cover their costs. CGAP (2004) adds that supervisory bodies must wait until there is a critical mass of profitable MFIs before regulating Micro finance. CGAP (2004) concludes that effective Micro finance regulation has tended to follow rather than lead the development of a strong Micro finance industry. With this background, regulators have found a tiered approach as a suitable regulatory framework for MFIs (Bank of Uganda, 1999).

Bank of Uganda regulates Micro finance business in tier 1, 2, and 3 under a special law while organizations in tier 4 are regulated under an umbrella Body (BOU, 1999). Tier 1-is made up of banks, as they already meet the requirements for taking deposits (Financial Institutions Act (FIA, 1990) and are allowed to go into the business of micro financing; Tier 2-consists of Credit Institution (CIs).The FIA, 1993 allows CIs to take deposits and the too are allowed to do Micro financing business, Tier 3-under this tier, MDIs are regulated, supervised and allowed to take deposits, Tier 4- comprises no deposit taking such as credit only NGOs, and those very small member-based organizations mobilizing subscriptions from their members.

Katimbo –Mugwanya (2000) recognizes that the Bank of Uganda supervises; Deposit taking. On mobilizing of deposits from the public, Greuning et al (1998) expound that banking laws govern this and state that banking laws should apply only to voluntary savings. Katimbo Mugwanya (2000) states that there is need to encourage an excellent capital portfolio quality so as to ensure that such financial institutions remain stable and avoid any likelihood of any systematic risk in the financial sector resulting from a collapse of these institutions. Greuning et al (1998) add that MFIs should be allowed mobilization of no deposit funds.

Katimbo Mugwanya (2000) mentioned that liquidity ratio requirements for Micro finance deposits are likely to be higher than those for commercial bank deposits. The New Vision (2005) stated that liquid asset requirements for licensed MDIs should be equal to or amount to 15% of the total deposit liabilities. Greuning et al (1998) explain that higher liquid rations result from higher administrative and operating costs and financial spreads for MFIs than for commercial banks. Supervision and regulation require clear identification and proximity of owners in the management and resolution of shortcomings. Supervisory authorities should be able to relate easily to the owners and that owners need to be fit and proper (Katimbo Mugwanya, 2000).

CHAPTER THREE

METHODOLOGY

3.0 Introduction

This chapter shows how the researcher conducted the study, methods which were used by the researcher in gathering, arranging, sorting and presentation of the data.

3.1 Research design

The researcher used a descriptive and analytical research design in establishing the relationship between Central Bank Regulations and the performance of Micro Finance Institutions. The study was based on qualitative data as appreciated by different authors on the same subject.

3.2 Data sources

The researcher used secondary data written by different authors on the study variables. The variables that formed secondary data were, Central Bank Regulation and the performance of MFIs. This data was obtained from Research reports, journal articles, conference published proceedings and research papers by different authors, some of which online.

3.3 Target Population and Sample

The target populations were the staff of Pride Microfinance in Mbale. Since the research is a cross-section survey, it may not cover all staff. The staff working at the district office and those at sub-county sub offices was selected. Stratified sampling was used to select the departments and sub-county respondents. At each level respondents were obtained by simple random selection, although the Heads of departments were purposively selected. The use of stratified sampling of departments and sub-counties ensured that they are all represented in the study and aiming at picking respondents from each job category.

3.4 Data collection

Since the research comprehensively looked at the works of different authors, the researcher collected data and made an analysis. Agreements and disagreements, similarities and differences all on specific concepts as given by different authors, were studied so as to identify the existing discrepancy in information. Review of related literature was used to help identify the relationship between the study variables.

3.5.1 Data Collection Sources, Methods and Instruments

Sources

The study used both primary and secondary sources. This is because the latter is considered insufficient for this study, if used alone.

3.5.2 Primary source

The employees of Pride Microfinance in sub-counties and district office were form the primary source of data for this study.

3.5.3 Secondary sources

The human resource departmental records formed the basis for secondary data, while the departmental and sub-county monthly reports formed supplementary reading materials.

3.5.4 Data collection method/instruments

A structured questionnaire was used to collect both quantitative and qualitative data from respondents. It was important that a self-administered questionnaire was ideal for exclusive use because all the respondents are literate and are within the proximity of the researcher. It was also flexible and time saving as it could be executed within a short time.

3.6 Data processing, analysis and presentation

Data by the different scholars collected from the various sources of literatures was compiled and edited to test for accuracy, completeness and relevancy. A descriptive correlation analysis was used to ascertain the relationship between the two variables. Once the data had been processed and analyzed, the qualitative data was presented in form of a report.

3.7 Procedure

The researcher first secured a letter of introduction from the School of Business and management that was presented to the District Pride Micro finance Office. This helped in seeking permission to carry out the study in the microfinance. There after, the selection exercise was followed. The researcher ensured that the filled questionnaires are collected as soon as they are filled to avoid loss and misplacement.

CHAPTER FOUR

PRESENTATION, DISCUSSION AND ANALYSIS OF FINDINGS

4.0 Introduction

This chapter looks at the interpretation and discussion of key issues obtained from the theoretical and empirical literature. These findings have been systemically compared and contrasted. Major issues have also been used to identify some inferences and insights into the problem. These are discussed objective by objective to draw meaningful conclusions.

4.2 Background of the Respondents

The researcher explored the respondent's background because it has got implications to the results of the study and as the results of the study will portray, the respondents that participated in the study were of different background characteristics ranging from their social economic and political situations.

The researcher was interested in establishing the distribution of employees by their Departments. The results are presented in Table (1).

Table 1: Respondents' distribution by Departments

Category	Frequency	Percent	Valid percent
Administrative	12	8.4	8.5
Planning	9	6.3	6.3
Loans	14	9.8	9.9
Finance	6	4.2	4.2
Community	8	5.6	4.9
Development	7	4.9	40.1
Customer care	57	39.9	17.6
Sub –countries	25	15.5	1.4
Promotions	2	1.4	2.1
Interest rates	3	2.1	100.0
management	**143**	**100.0**	
Total			

From Table (2), it is indicated that the study involved different categories of respondents in Pride Micro finance. The Majority of the respondents 57 (39.9%) were from the customer care Department. These included head teachers, Deputies and teachers. Respondents from sub-counties administration were 25 (17.5%). This category included the sub county coordinators, secretaries and finance officers in the Company. Other categories of respondents were from loans Departments 14 (9.8%) Finance, planning, production and community Development.

The researcher explored the status or position of the respondents in their departments. This was important because the District salary structure varies with the employees' positions. Table (2) illustrates the situation that was established from the study.

Table (2) status of the respondent in the Department

Category	Frequency	Percent
Valid Junior staff	25	17.5
Middle staff	50	34.3
Senior staff	40	28.0
Heads of Department	27	18.9
Total	141	98.6
Missing system	2	1.4
Total	143	100.0

From Table (2), most of the respondents were in middle staff positions 50(34.4%) while those in senior positions were 40 (28.02%). The junior staff comprised 25(17.5) with heads of department comprising 27(18.9%). The Heads of department were considered separately because some people were middle staff or senior staff and at the same time were heads of Departments with various privileges like allowances of travel and housing which the other staff did not have. This forced the researcher to consider them differently from the other staff.

The researcher was also interested in exploring the marital status of the respondents. This was necessary because in the real work situation it affects employee satisfaction with the salary offered. This is because people's needs are different depending on whether they are married, number of children and other dimensions related to the marital status of the respondents. Table (3) shows the descriptive distributions of the marital status of the respondents.

Table (3): Marital status of the Respondents

	Frequency	Percent	Valid percent
Valid Single	18	12.6	12.6
Married	108	75.5	76.1
Divorced	6	4.2	3.5
Widower/er	10	7.0	7.0
Total	142	99.3	100.0
Missing system	1	.7	
Total	**143**	**100.0**	

From Table (3), most of the respondents were married people. That is 108 (75.5) of the total respondents. Those who were single were 18(12.6%) while the widow/er were 10 (7.0%) with 6 (4.2) having divorced. The above picture indicates that people could be having a series of family obligations because most of them are either married, widows or divorced and this has an implication to satisfaction derived from the amount of salary offered by government, which will be established in the proceeding presentations.

The researcher also tried to explore the nature of employment of the respondents. He was interested in establishing the number of employees employed on permanent, Temporary or probation basis. The results are indicated in Table (4).

Table (4): Employees' employment status

Category	Frequency	Percent	Valid percent
Valid probation	12	8.4	9.6
Temporary	12	8.4	9.7
Contract	13	9.1	9.8
Permanent	100	69.9	70.9
Total	140	95.5	100.0
Missing system	3	4.2	
Total	**143**	**100.0**	

From Table 4, it is shown that most of the employees in local government are employed on a permanent basis. That is 100 (69.9%) out of the total respondents surveyed, indicated that they were on permanent basis. Those on probation were 12 (8.4%). When the researcher discussed with the respondents who indicated were on probation, most of them said, it is a local government policy that employees first be employed on probation and then later promoted to a permanent basis. They also indicated that it has implications on the salary offered whereby when some one is elevated to a permanent basis, he gets a higher salary than when he was on probation. Those who were employed on contract basis where 13 (9.1) while 11 (7%) where employed on a temporary basis. The whole situation however indicates that there are various categories of employees in Pride Microfinance and this situation can be used to explain the variability in salary as explained by table (5)

Table (5): Employees salary structure

Category	Frequency	Percent
Valid U1	2	1.4
U 2	9	6.3
U 3	21	14.7
U 4	34	23.8
U 5	31	21.7
U 6	21	14.7
U 7	25	17.5
Total	**143**	**100.0**

From Table (5), it is indicated that most of the employees are in U4 category. That is, 34 (23.8%) and U5, which were 31 (21.7%) of the total respondents. U3 and U6 had an equal number of 21 (14.7%) each whereas U7 had 25 (17.5%). U1 and U2 which are the highest bracket group in Government salary structure were very few. That is U1 only 1(one) respondent while U2 were only 9 respondents. This indicates that the majority of the local government officials (employees) receive low salary and this could have an implication to salary and motivation of employees to work.

4.3 Means of Central Bank regulation of MFIs

In respect to this objective, it was discovered that several supervisory authorized could regulate MFIs. Most scholars agreed that the Central Bank was as equally suited to regulation of MFIs as it is to regulation of banks.

Researchers and scholars classified MFI regulation by the central Bank into prudential and non-prudential regulation where prudential is used on deposit-taking institutions and non-prudential is used for non deposit-taking institutions

A critical discovery was that the Central Bank regulates MFIs in order to ensure financial soundness of the economy as well as protecting savers' deposits by turning some MFIs into MDIs. (Daily Monitor, 28th November, 2007, Page 1).

There was consensus from many scholars that the tiered approach was appropriate for the regulation of MFIs, where they are put into different categories. Institutions in the several categories are regulated under special rules and allowed to grow and advance to tiers above. In Uganda, MFIs are regulated in tiers 1, 2, 3 and with banks, credit institutions, MDIs and credit-only NGOs under the four tiers respectively.

The central bank also sets up regulatory principles for MFIs to follow, and many scholars generally classified them into deposit-taking, capital requirements, liquidity and ownership and governance principles.

MFI regulation was discovered to be necessary because; MFIs need regulatory recognition in order to access deposits, regulation is seen as reputation enhancing, it is a means of curbing troublesome institutions, it ensures solvency and soundness of financial intermediaries, protects the stability of the country's payments system, protects consumers against bank failures, promotes market efficiency and the appropriate functioning of competitive market forces. New line regulation was found to be limited by incremental costs that MFIs have to face to meet requirements, a possibility of repression of innovation and flexibility, as well as a danger of applying structures that are not appropriate to microfinance. (David. L. Kalyango, 2004).

In many opinions, an optimistic that an economy would benefit from having a considerable number of regulated MFIs due to the advantages accruing. However, I am of the view that it is because of the high supervisory costs to Central Bank, high capital requirements to the MFI as well as a weak supervisory structure that few MFIs have been turned into MDIs that is, FINCA, Uganda Microfinance Ltd, PRIDE Uganda Ltd and Uganda Finance Trust. Furthermore, regulation does not guarantee atmost protection of consumers from non-viable providers of Micro-finance.

4.4 Level of Client Outreach Achieved by MFIs

With regard to this objective, some scholars were of the view that expanding the number of clients is the ultimate goal of many MFIs. Consequently, the number of accounts that are active at a given point in time is more important than the cumulative number of loans or clients served during a period.

There was disagreement as to the level of client outreach. One group of scholars concluded that there has been limited growth in client outreach despite the expansion of MFIs, where as other researchers cited parts of the world where client outreach has grown. India was one example. It was found out that African MFIs are in a better position to reach the poorest clients than MFIs in other regions of the world. African MFIs have focused on savings and it was discovered that many of these MFIs were NGOs that target women groups.

Outreach numbers were found to vary by region as well as MFI type. Unregulated MFIs were found to make up 22% of MFIs in Africa and reach out to 11% of borrowers and 4% of voluntary savers, regulated MFIs, on the other hand were found to be bigger than the unregulated MFIs and accounted for a bigger percentage of both borrowers and savers.

Scholars and researchers gave different means by which outreach can be increased. One of these was through concentrating on a small number of MDIs to ensure quality services, whereas another argument was that this would not be as efficient as using the smaller MFIs that are already located in the rural areas, with the explanation that the bigger regulated MFIs would take a shorter time to reach the rural areas.

Other means of reaching poorer areas were; technological innovations, product refinements, and strengthening of capacity of African MFIs. In many opinions, regulation is capable of improving outreach, if the regulated MDIs can utilize their resources and by using the opportunity of being allowed to take deposits to spread their services to the rural areas. However, regulation alone is not sufficient to increase the quality and extent of client outreach.

4.5 Relationship between MFI Regulation and client outreach

Regulation was seen as a way to achieve increased outreach to several MFIs, especially NGOs. However, it was mentioned by scholars that in order to achieve increased supply of financial services to the poor through regulation, a complex intervention would be undertaken.

Using regulation to enhance provision of services has to target protection the interests of the poor as well as overall integration of the service to result in increasing the flow of resources to the poor. In order for regulation to achieve increased spread of financial services to the poor, a favorable policy and legal environment, operational and performance standards, innovation, and capacity building are required.

Upon comparison of regulated and un regulated MFIs with regard to client outreach, regulated MFIs were found to reach more clients because the regulations in many countries favor the mobilization of savings by regulated institutions. However, unregulated MFIs reach poorer clients. Regulated MFIs were found to have increased in their number borrowers and savers. Statistic by researchers revealed that for regulated MFIs, borrowers increased by 51% and savers by 66% compared to 22% and 30% respectively for unregulated MFIs. However, regulated MFIs were found to serve a smaller number of male clients as compared to unregulated MFIs.

CHAPTER FIVE

CONCLUSION AND RECOMMENDATIONS

5.0 Introduction

This chapter presents a summary of findings and concluding remarks, the researcher additionally give recommendation s and areas of further researcher.

5.1 Summary of Findings

The aim of the study was to find out the relationship that exists between central bank regulation and performance of microfinance institutions. As a solution to the poor who were not being served with financial services by the main stream financial institutions like commercial banks, MFIs were introduced. The study disclosed that in some parts of the world MFIs have achieved the reason for their existence whereas in other areas, the level of client outreach is still inadequate despite the large number of MFIs. Regulation of MFIs by the central bank is one of the ways through which client outreach can be increased.

While regulated MFIs reach out to more clients in number, they are still not serving the most underprivileged rural occupants. The finding also suggested that regulation of MFIs has a positive effect on the growth of the sector brought about by MFIs that are getting licensed and the increased number and the overall deposit collections over the last three years since the MDI Act was enacted. The study also suggested that regulation is not the ultimate way to increase client outreach. other factors such as; technology, innovations, product refinements and capacity strengthening of African MFIs can work to enhance client outreach.

5.2 Conclusions

For MFIs to serve more of the underprivileged and the poor people, several policies will have to be implemented. Among others, regulation is one of them because it will work for MFIs to increase their range of services through deposits. On the other side however, to only rely on the regulation of MDIs it is not adequate but also on non-deposit taking institutions to ensure stability of the economy. This will work to ensure that MFIs fulfill their objectives.

In many opinion, in order to improve outreach through regulation, MFIs need to learn to overcome the high costs, increase their operations volume, and more MFIs turned into MDIs to achieve levels of efficiency that can guarantee their continued performance where it is not possible to have as many MDIs as required, small MFIs should be strengthened through internal governance and non-prudential regulation so that the poorer clients being served by these small MFIs get better quality services.

5.3 Recommendations

The following recommendations, once implemented, can help enhance client outreach;

i) The central bank should see to it that it increase its liaison with MFIs especially through AMFUI and other avenues.

ii) Authorities should enhance regulation of non-deposit taking institutions like NGOs so as to safe guard the financial sector and the public as well.

iii) The regulated deposit taking institutions should endeavour to extend their services to the most underprivileged for example targeting the women groups as they are less susceptible to loan default.

5.4 Recommended areas of further study

i) Enhancing the ability of prudential regulation to mop out market inefficiencies

ii) Improve Central Bank's supervisory capacity.

iii) Other pertinent ways of improving standards of the living of the poor.

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APPENDIX I

Self Administered Questionnaire

Dear Respondent.

This questionnaire is part of the study being carried in Wakiso Local Government. It is intended to find out the relationship between salary and employee motivation in Local Governments.

The information provided is meant for academic purposes and therefore will be treated with utmost confidence it deserves.

Please answer the questions as freely and fairly as possible.

Your cooperation and contribution will be highly appreciated.

Thanking you in advance.

SECTION A: BACKGROUND INFORMATION

1. Sex of Respondent 1. Male ☐ 2. Female ☐

2. Highest level of academic qualifications

    1.'O' Level /equivalent ☐

    2. 'A' level / equivalent ☐

    3. Diploma ☐

    4. Bachelor ☐

    5. Post Graduate Diploma ☐

    6. Masters ☐

    7. PhD ☐

3. Department under which the Respondent works

1. Administration ☐ 2. Planning ☐

3. Health ☐ 4. Production ☐

5. Finance ☐ 6. Community Development ☐

7. Education ☐ 8. Sub-counties ☐

9. Water ☐

4. Level / Title / Status of the Respondent.

1. Junior staff ☐ 2. Middle staff ☐

3. Senior staff ☐ 4. Heads of Departments ☐

5. Marital status.

1. Single ☐

2. Married ☐

3. Divorced ☐

4. Widow/er ☐

(b) The status of Respondent.

1. Probation ☐

2. Temporary ☐

3. Contract ☐

4. Permanent ☐

IN SECTION B, C, D & E, TICK OR CIRCLE THE APPROPRIATE RESPONSES OR WRITE IN THE SPACE PROVIDED.

SECTION B

6. In what range does your MFI income fall?

a) Below & 100,000,000 b) & 100,000-200,000

c) & 210,000-300,000 d) & 310,000-500,000

e) & 510,000-700,000 f) & 710,000 and above

7. What is your opinion about the current employees' salary levels within Your organization?

a) Very Good b) Good

c) Fair d) Poor

e) Very poor.

		1	2	3	4	5
		Strongly disagree	**Disagree**	**Neutral**	**Agree**	**Strongly Agree**
8.	The Central bank is committed to achieve its corporate goals.	1	2	3	4	5
9.	subscription is paid according to the number of years served.	1	2	3	4	5
10.	There is fairness (equity) in Central Bank regulations	1	2	3	4	5
11.	Payment by MFIs is always made in time.	1	2	3	4	5

	does Central bank controls affect performance of MFIs	If yes, Explain.............................. ....

SECTION C. EFFECTS OF SALARY ON EMPLOYEES ATTITUDE TO WORK.						
		1	**2**	**3**	**4**	**5**
		Strongly disagree	**Disagree**	**Neutral**	**Agree**	**Strongly Agree**
19.	we fell we are on good terms with Central bank	1	2	3	4	5
20.	Our performance has improved over the years	1	2	3	4	5
21	My current salary gives me inspiration to work harder and perform at my best.	1	2	3	4	5
22.	Central bank is political					

		1	2	3	4	5
23.	Inflation is controlled	1	2	3	4	5
24	We get all the information necessary	1	2	3	4	5
25.	The regulations are flexible	1	2	3	4	5
26.	There is satisfaction with customers	1	2	3	4	5
27.	The MFI is performing at a deficit	1	2	3	4	5
28.	There is stiff control	1	2	3	4	5
29.	MFI officials participate in policy	1	2	3	4	5
30.	Central bank is weak	1	2	3	4	5
31.	MFIs are not motivated	1	2	3	4	5
32.	The most important thing is professionalism	1	2	3	4	5
33.	MFIs feel are in a good					

	enviroment	1	2	3	4	5
34.	MFI activities are well monitored	1	2	3	4	5
35.	The lending system is good	1	2	3	4	5

End