GOVERNANCE AND PERFORMANCE OF MICROFINANCE INSTITUTIONS IN RWANDA, A CASE STUDY OF VISION FINANCE COMPANY S.A

TUMWINE VENANT

MBA/28780/82/DU/KBL

BBA (FINANCE, KIST)

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Declaration

I, Tumwine Venant, declare that the work presented in this dissertation entitled "Governance and Performance of Microfinance Institutions in Rwanda, A case of Vision Finance Company S.A," is my original work and has not been submitted for the award of Diploma or a Degree in any other university or college or institution of high learning.

Signature___________________

Date 14/11/2012

APPROVAL

This final copy of the dissertation has been submitted with my approval.

Signature____________________ Date 14/11/2012____________

Mr. Manyange Michael

SUPERVISOR

DEDICATION

I dedicate this dissertation to Almighty God, my family members, parents, relatives, and fellow students for patience, love and support for this remarkable academic achievement. I sincerely appreciate Vision Finance Company S.A staff and leadership for their support in completing this work.

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TABLE OF CONTENTS

LIST OF TABLES

LIST OF ABBREVIATIONS

AMIR: Association of Microfinance Institutions in Rwanda

CBU: Capital Build Up

CEO: Chief Executive Officer

CGAP: Consultative Group to Assist the Poor

IRR: Internal Rate of Return

MFI: Microfinance Institutions

MFOs: Microfinance Organizations

NBR: National Bank of Rwanda

NGO: Nongovernmental organizations

OSS: Operational Self-sufficiency

RDB: Rwanda Development Bank

ROA: Return on assets

SA: Society Anonym

SHFs: Shareholders Firms

SME: Small and Medium Enterprise

UN: United Nations

VFC: Vision Finance Company SA

ABSTRACT

In 2003 Government of Rwanda established a number of microfinance institutions but many of them were closed down since 2006 to date. To find out the causes, a research study was carried out to ascertain the relationship of governance and the performance of microfinance institutions by applying the following objectives: Ascertain financial stability of microfinance institutions and the nature of products and services provided to their clients, establish how microfinance institutions select clients in loan applications, identify the internal controls and credit monitoring systems applied by microfinance institutions in loan recovery. In order to achieve the objectives the following research questions were formulated: Are the Microfinance Institutions financially stable? What are the products and services provided to their clients? How do Microfinance Institutions select clients in loan applications? What are the internal controls and credit monitoring systems applied by Microfinance Institutions in loan recovery? Researcher used primary and secondary data of descriptive in nature to study the nature, structure and operation of Microfinance Institutions. Self administered questionnaires were used to collect and present data for findings and conclusions. It has been observed that Microfinance Institutions are largely financed by interest income, borrowed funds, donations and grants. Clients are selected based on ability to repay, credibility and government recommendations. Microfinance Institutions have written manuals, and employs external and internal audits. Over the last three years governance and performance of microfinance institutions has greatly improved due to monitoring of national bank and its stringent requirements for establishment and operation of Microfinance Institutions. It has been recommended that Microfinance Institutions should invest more in treasury bonds and increase banking services to increase its deposits, while reducing dependency on borrowed funds, grants and donations. Researcher recommends for further research on life impact analysis of the poor.

CHAPTER ONE

1.0 Introduction

Following the 1994 genocide in Rwanda, the microfinance industry experienced spectacular development, with the support of international organizations involved in humanitarian assistance. Humanitarian organizations provided microcredit loans to the poor to set up microenterprises but most of these loans were taken as grants and never repaid. As the government moved into a development phase, several International Nongovernmental organizations established microfinance institutions, in many cases operating without professionalism.

During year 2005, more than 230 microfinance institutions had been established across the country many of them with no operational license and requirements of the national bank. In 2006 some of the Microfinance Institutions went bankruptcy and were liquidated. The causes of bankruptcy according to national bank includes non compliance with cooperative principles, directors' past due loans and high operating expenses, rate of high non performing loans, unstable income statement, negative net worth or low solvency ratio to the required minimum of 10%, strong dependence to subsidies(Rwanda MFI policy, 2009).

1.1 Background of the study

1.1.1 Historical Perspective

Microfinance arose in the 1980s as a response to doubts and research findings about state delivery of subsidized credit to poor farmers. Beginning in the mid 1980s the subsidized, targeted credit model supported by many donors was the object of criticism, because most

programs accumulated large loan losses and required frequent recapitalization to continue operating. It became more and more evident that market-based solutions were required. This led to a new approach that considered microfinance as an integral part of the overall financial system. Emphasis shifted from the rapid disbursement of subsidized loans to target populations toward the building up of local, sustainable institutions to serve the poor.

Since the 1980s the field of microfinance has grown substantially. Donors actively support and encourage microfinance activities, focusing on Microfinance Institutions that are committed to achieving substantial outreach and financial sustainability (Ledgerwood,2000).

The microfinance is a sector that is relatively new, it has been existing since three decades ago. In spite of its youngest stage, this instrument is becoming more and more ineluctable for poverty reduction in Africa and over the world especially in developing countries. Up to the beginning of the year 1990, the microfinance has been considered as facto by the government authorities, development partners and Nongovernmental organizations as a particular social activity. Most of microfinance programmes were then enlisted until recent time in social development projects, rural and/or collective. The qualifications required to managers of institutions, very often selected according to the profile that is generally social, and community development oriented, did not require exceptional competences as regard to financial and banking management. Many Microfinance Institutions do not currently possess the capacity required to operate in a secure and sustainable manner. They still focus on urban or semi-urban areas and do not offer adequate financial products adapted to the low-income bracket of the population. The situation has been aggravated by the lack of a national policy on microfinance, the lack of an enabling legal framework and of mechanisms to enable optimal exploitation of opportunities offered by the microfinance sector (Ledgerwood,2000).

At the level of beneficiaries, over-indebtedness of some beneficiaries is as a result of multiple loans from several Microfinance Institutions, abuse or no respect of the rules of group guarantee, poor allocation of credit characterized by its use for means other than those specified in the credit agreement which may result in inability to repay, old habit of receiving gifts, which allows persons with malicious intent to refuse to repay credit on the grounds that the funds were for poverty reduction, lack of capacity to identify profitable projects and lack of information on investment opportunities

(Ledgerwood, 2000).

At the level of Microfinance Institutions, more were often not run in a professional manner and lack of transparent norms and performance indicators, thus hindering efficient management of financial and non-financial operations. Lack of transparency in pricing of products and services and disregard of regulations, destructive competition and poor governance characterized their poor performance. Microfinance Institutions were characterized by conflicts of interests, disregard of cooperative principles, high rates of non-performing loans to several Microfinance Institutions. Financial discipline and lack of sufficient equity to guarantee the repayment of deposits characterized their operations. It was noticed that human capacity, equipments and investment capital (long term resources) was hindering factor to their development.

Because of the duplication of microfinance programmes and the risks of troubles and conflagration of this sector, an overall awareness has started at the level of governmental authorities, development partners and operators at the beginning of 1990, the exacting legal and regulatory framework especially as far as institutions collecting deposits from its members or the public are concerned (Rwanda National Bank supervision report, 1995-2007).

The United Nations Assembly declared the decade 1997-2006 a decade of poverty eradication. A general microcredit campaign began in 1997, with the global objective of bringing local financial services for self-employment to

100 million impoverished families, especially women, by 2005. In addition, 2005 was declared the 'International Year of Micro Credit' by the United Nations, underlining the increasing importance and high profile of microfinance. The International Year of Micro Credit had five objectives: Evaluate and promote the role of microfinance and micro credit in the attainment of the Millennium Development Goals, sensitize the public on the role of microfinance and micro credit in development, promote inclusive financial markets guarantee the sustainability of microfinance services, encourage innovation and partnership, and extend microfinance networks (Rwanda MFI policy, 2009).

1.1.2 Theoretical Perspective

Theoretical perspective of this study is guided by stakeholder, agency, and Pecking Order theories.

In microfinance, governance refers to the mechanisms through which donors, equity investors and other providers of funds ensure themselves that their funds will be used according to the intended purposes. Such control mechanisms are necessary because managers and providers of funds may have diverging preferences and objectives. For example a manager of MFI may work towards fulfilling the mission of the MFI but they may also have preferences for non-pecuniary rewards. In corporate governance literature, this problem is known as the agency problem. This literature refers to the manager as an agent, who unlike the principal, does not own the resources of the firm. The principal owns the resources and bears the residual risk, that is, the principal is the residual claimant of the firm's wealth.(Jensen & Meckling,1976). Costs associated with the agency problem are called agency costs and represent costs that residual claimants bear in order to benefit the professional services of the managers. The goal of many governance mechanisms is to minimize agency costs by aligning the objectives of the owner-principal with objectives of the manager-Agent (Jensen & Meckling,1976)

Agency theory suggests that board independence influences microfinance institution performance positively. Instead of offering performance-based compensation as agency theory would suggest, non-profits boards may be able to recruit managers by offering compensation packages combining lower wages with some perquisites that only individuals committed to the mission will self-select to take (Handy & Katz, 1998). Additionally, the appeal of a position of power in non-profit firms may be sufficient to attract good managers (James, 1983). It has been shown that if wages paid to Nongovernmental organizations managers are similar to those paid to profit making organization managers, and if the Nongovernmental organizations technology is superior to that of the profit firm, the Nongovernmental organizations will dominate the industry (Scott & Hopkins, 1999).

The key mechanisms of an effective governance framework are ownership (including institutional and managerial ownership), board and board structure (size and composition), CEO (manager) and director (board member) remuneration, auditing, information, and the market for corporate control (Keasey, Thompson & Write 1997).

Performance in microfinance is multidimensional. To allow a comparison of Nongovernmental organizations and shareholder owned firms (SHFs) the researcher used schreiner's(2002) highly conceptual terms to discuss the performance of Microfinance organizations(MFOs). According to schreiner's framework, there are six aspects of social benefits for microfinance clients. The six aspects can all be considered performance dimensions in a microfinance organization. The six dimensions are: Cost, depth, breadth, scope and worth, where cost is defined as the sum of monetary costs and transaction costs to clients, depth is defined as clients' poverty level or other social preferences like for instance the percentage of women reached, breadth is defined as the number of clients served, length is defined as the time frame of the supply of the services and scope is defined as number of times of financial contracts supplied. Worth estimates to what the degree the clients value the services.

Hartarska(2005) in her study on corporate governance in East Europe MFOs included ownership type as an independent variable in her model. Similarly Cull et al. (2007) included ownership type as a control variable in their study on the influence of lending methodologies on performance. In none of the studies ownership type had a significant influence on the performance of MFOs. In another study Hartarska and Nadolnyak(2007) found that regulation did not affect either social nor performance in MFOs. Since most countries do not allow Nongovernmental organizations to become regulated the Hartarska and Nadolnyak study is of particular relevance for this study.

In line with the Pecking Order Theory (Myers/Majluf) the Microfinance Institutions have to prioritize the various sources of financing. Typically, the issuance of equity is costly and often structurally limited considering the Nongovernmental organizations nature of most Microfinance Institutions (except grant equity or donations).

1.1.3 Conceptual Perspective

In this study, there are two concepts; Governance and Performance. Governance is dependence variable while Performance is independent variable. According to Ledgerwood,(2000), Governance refers to a system of checks and balances whereby a board of directors is established to oversee the management of the MFI. The board of directors is responsible for reviewing, confirming and approving the plans and performance of senior management and ensuring that the vision of the MFI is maintained. Management is responsible for the daily operations of putting the vision into action. The basic responsibilities of the board include fiduciary, strategic, supervisory and management development. Performance refers to the formal process of doing an action as a means of implementing MFI strategic plans to achieve its Vision.

Performance refers to the formal process of doing an action as a means of implementing MFI strategic plans to achieve its Vision. Financial performance is assessed in terms of overall profitability, through such measures as return on assets (ROA), operational self-sufficiency (OSS), revenues (portfolio yield), and operational costs (Christen, 2000).

Microfinance Institution refers to those organizations that are characterized by their commitment to assist poor families, micro-entrepreneurs, and impoverished women in gaining access to financial services.

1.1.4 Contextual perspective

Governance is about achieving corporate goals. The first goal of Microfinance Institutions is to reach more clients in the poorer strata of the population, and the second goal is financial sustainability. According to Marsland (2009), most corporate governance mechanisms have little impact on Microfinance Institutions' financial and outreach performance. Marsland identified corporate governance as a principal risk facing microfinance, threatening its role as both a business and a social service (CSFI, 2008). However, studies by Mersland and Strøm (Forthcoming) and Hartarska (2005) find that best practice governance mechanisms from regular firms in mature markets do not generally have much influence on the performance of the Microfinance Institutions. Thus, there is a need for a different and more original approach to identify and better understand the governance mechanisms that can enhance Microfinance Institutions' long-term survival.

Microfinance is high on the public agenda after the UN Year of Microcredit in 2005 and the awarding of the Nobel Peace Prize to Mohammad Yunus and the

Grameen Bank in 2006. Nevertheless, microfinance still reaches only a fraction of the world's poor (Robinson, 2001; Christen et al., 2004).

In 2006, National Bank of Rwanda reported a number of microfinance institutions closed down due to poor governance that resulted huge losses of funds, poor management of credit files and failure to meet with the approval conditions.

1.2 Statement of the Problem

The civil war of early 1990's culminated in 1994 genocide and total breakdown of the governance machinery, social and economic infrastructure and family and community bonds, upon which human development was based. To rebuild the country, private sector was the primary focus and Government of Rwanda recognized the role of Microfinance Institutions in attaining government's vision 2020 programme which consist of transforming Rwanda from a low-income country with a dynamic, diversified, integrated and competitive economy. It was seen as an important instrument in the implementation of the government programme to reduce the number of people below the poverty line from 60% in 2000 to 30% in 2015. Microfinance institutions were viewed as one of the private sectors that will lead the country to attain this vision. Rwanda microfinance policy of 2009 reported establishment of 230Microfinance Institutions in 2005 while national bank report of 2006 indicates the existence of 223Microfinance Institutions meaning a drop of 7Microfinance Institutions. National bank report of 2007 revealed a total of 9Microfinance Institutions closed down due to mismanagement of funds. While economic growth were on the increase and other facets of human development were equally improving, micro finance gains from such economic development were marginal hence access to loans was limited than expected. Furthermore, questions arise when global commitments to promote microfinance see it as a strategy for economic development. Such a contribution would help to validate as to whether or not microfinance can be popularized across the country as an engine of economic development or not.

1.3 Purpose of the Study

The overall aim of the study was to find out the relationship between governance and performance of microfinance institutions in Rwanda taking a case study in Rwanda Vision Finance Company SA.

1.4 Objectives of the Study

1.4.1 General Objective

The general objective of the study was to find out how microfinance governance impacts the performance of Rwanda microfinance institutions and propose the corrective actions.

1.4.2 Specific objectives

(i) To ascertain financial stability of microfinance institutions and the nature of products and services provided to their clients.

(ii) To establish how Microfinance Institutions select clients in loan applications.

(iii) To identify the internal controls and credit monitoring systems applied by Microfinance Institutions in loan recovery.

1.5 Research Questions

The study seeks to answer the following questions:

(i) Are the Microfinance Institutions financially stable? What are the products and services provided to their clients?

(ii) How do Microfinance Institutions select clients in loan applications?

(iii) What are the internal controls and credit monitoring systems applied by Microfinance Institutions in loan recovery?

1.6 Significance of the study

The research findings will be useful in formulating the governance policies and handling issues and challenges currently faced by microfinance institutions in Rwanda. It will be resourceful materials for the ministry of finance and economic planning and the national bank to come with the laws and rules governing the banking system in the country and to streamline the requirements for microfinance registration.

The research results will be a tool for microfinance performance evaluation and redesign of microfinance best performance approach to economic development and poverty reduction.

The research results will enrich academic students and lecturers in adding knowledge of research methods and understanding the performance of the microfinance. It will also give awareness to the whole community about the functioning of the microfinance enterprises, the risk products and services and the best investment opportunities available.

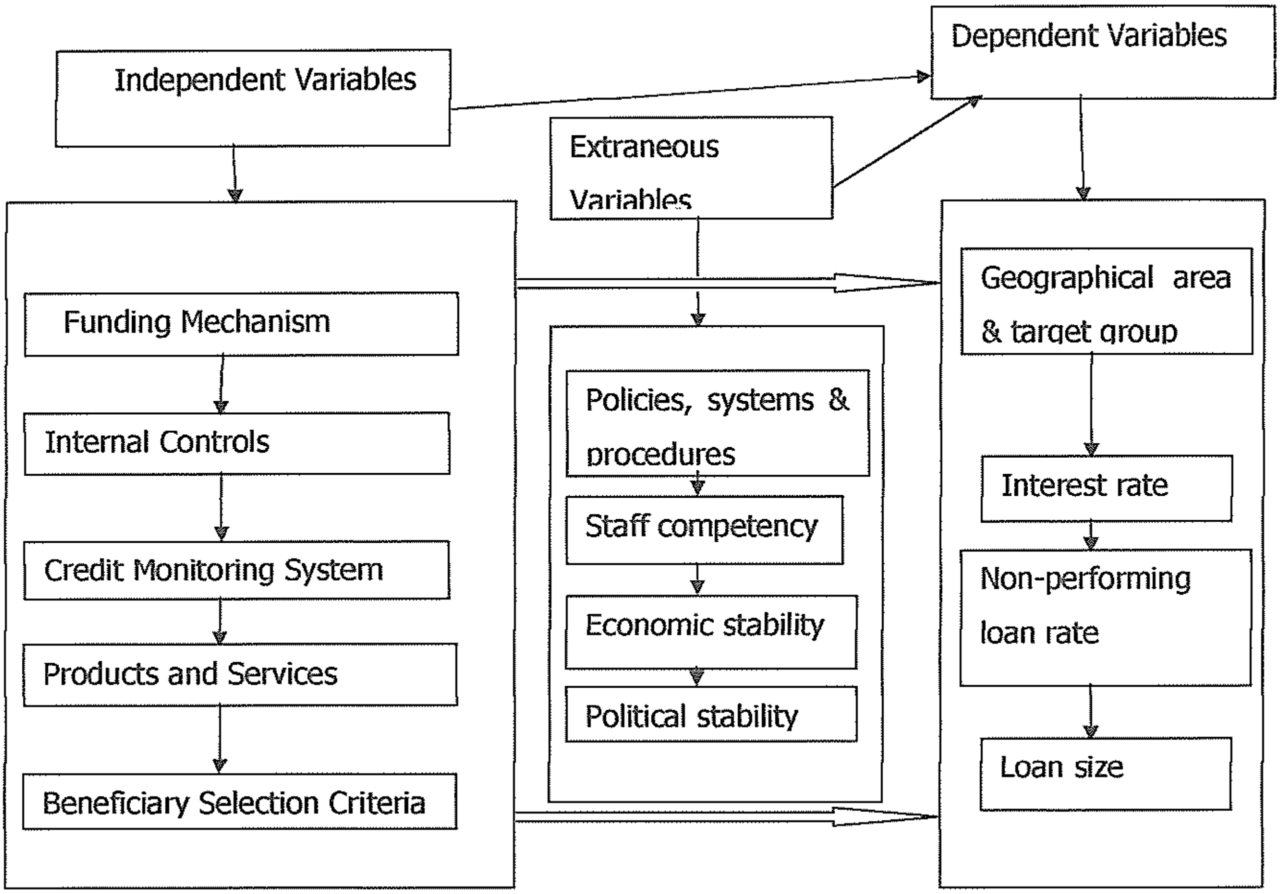
The research results will be a basis for future further researches to be carried out by research practitioners and academic students.

The research materials will be a mirror to microfinance institutions and guidance to management in their restructuring process, recruitment approach, revising internal controls, products and services.

1.7 Scope of the study

This study was concerned with the governance and performance of microfinance institutions in Rwanda. It was conducted in Kigali and branch offices of Rwanda Vision Finance Company SA across the country. It covers a period between 2005 and 2010.

1.8 Conceptual Framework



Source: Researcher's diagrammatic presentation of variables

Conceptual framework was made up of independent and dependent variables interconnected by extraneous variables. Governance was the independent variable and characterized by funding mechanism, internal controls, credit monitoring system, product and services and beneficiary selection criteria.

Performance was dependent variable and covers geographical area, target group, interest rates, loan rates and loan size. Both independent and dependent variables were interconnected by policies, systems, procedures, staff competency, economic stability and political stability. Independent and dependent variables and their relationships were explained in the literature review

2.3.3. The government Program: 2003-2010

The government program comprises four major pillars, namely:

Good governance; justice and rights of person; economic development; social welfare of the population

Microfinance activities support the economic development pillar in the promotion of agriculture, trade and commerce, industry, and handcraft, tourism, investment, infrastructure and rural development.

The government is committed to the establishment of mechanisms aimed at facilitating to credit facilities by farmers, and to provide guarantees of such credits by creating an appropriate facility.

2.3.4. National Decentralization Policy

MFIs are the effective partners of local government because of their active participation in "Joint Action". Moreover their ability to offer financial services at decentralized levels and their assistance in building of the local population is also of importance to the decentralized process.

2.3.5. Rwanda microfinance forum

The Rwanda microfinance forum was created in June 2000 as a plat form of which all organizations that intervene in microfinance activities in Rwanda, could articulate the visions and air their concerns. Its vision is to build a strong microfinance sector accessible by a large number of the public especially low-income groups.

2.4 THE CATEGORIZATION AND REGULATION OF MFIs

MFIs are sub divided into four categories according to the operations that are allowed to them, the structure of functioning and control, the rules of management and/or demanded prudential norms and the importance of risks linked to the activities of microfinance.

provision of small-scale financial services (loans, savings, insurance etc) to lower income individuals; this client base is also referred to as marginalized by mainstream financial institutions.

Microfinance is about giving low-income people access to financial services, typically by lending tiny amounts of money to people who usually to borrow from traditional financial institutions, mostly because bank don't serve those who cannot offer traditional collateral and with no credit history.(Marco, 2009).

Microfinance Institution refers to those organizations that are characterized by their commitment to assist poor families, micro-entrepreneurs, and impoverished women in gaining access to financial services.

Microfinance Institutions are not a rarity anymore but are becoming first class members of financial and banking systems at least in developing countries. Their growth parameters are outstanding both in number of firms and clients. According to Daley-Harris (2005), 3,164 microcredit institutions reported reaching 92.3million clients as of December 2004. The number of poorest clients grew from 54.8million at the end of 2003 to 66.6million at the end of 2004. This represents 21.6% annual growth rate (Begona, 2007).

The focus of Microfinance Institutions in social matters appears to be their main attraction. Many of their borrowers are socially excluded, and they lack access to conventional credit systems (Begona, 2007).

2.2 Funding mechanism

Microfinance Institutions obtain their funds from two main sources: (a) financial markets and (b) donors and socially responsible investors. Donors' interest in microfinance has increased substantially over the past few years. Virtually all donors, including local, bilateral, and multilateral government donors and local and international Nongovernmental organizations, support microfinance in some way, providing one or more of the following services: grants for institutional capacity building, grants to cover operating shortfalls, grants for loan capital or equity, concessional loans to fund on-lending, Lines of credit, guarantees for commercial funds and technical assistance.

Because donors are primarily funders of microfinance activities, the approach they take to microfinance and requirements they set for Microfinance Institutions to access funding can greatly affect the development of the field of microfinance. Most donors have moved away from subsidized lending and are focusing more on capacity building and the provision of loan capital (Ledgerwood, 2000).

Micro-enterprise development is currently the favorite recipient of large bilateral and multilateral technical donors including USAID, AUSAID, DFID and the European community. These donors fund organizations which can demonstrate 'return on investment viability'. This is means that in addition to having high repayment rates, organizations must have an extremely low cost of delivering the loans, a large clientele, be able to access commercial loans to bolster the organization's portfolio, and charge a high real interest rates in order to provide a return on equity invested. The end goal of this funding is to convert micro-enterprise into profit financial institutions so that they can lend even to a great number of people (Bussau, 2000).

Issues raised by secular donor priorities:

Extremely low cost of delivering funds

The microfinance industry mandates that the cost of delivering funds to the clients should not exceed 15 to 20 cents per dollar. To achieve this rate of efficiency a project officer must service large number clients, often over 300. Technical donors would prefer to see the efficiency rate of commercial banks – 4cents per dollar loaned.

This strong emphasis on efficiency introduces a minimalist position that makes effective project officer-client relationships difficult and may force implementing partners to eliminate the very support services that are necessary to meaningful client transformation.

Accessing commercial funds

The microfinance industry is generally steering microenterprise organizations towards accessing commercial loan funds instead of grant funds, although some smaller grants are made with the stipulation that they be used to leverage a larger commercial loan. The debt equity ratios for microfinance organizations range from 4:1 to 10:1. As a result the board of directors rather than focusing on the vision and transformation within communities must be concerned primarily with managing other people's money (Bussau,2000).

Table 1.1: Microfinance Institutions Financial and Statistical Information as at 31/12/2006.

Exchange rate:550RWF/$

Number of Microfinance Institutions	223
Number of members(for SACCOs)	1,464,811
Number of clients(for SA SARL)	108,799
Total Assets:	97,248,420,690
Cash	2,560,096,340
Demand deposits	4,142,154,705
Time deposits	3,233,809,212

Treasury bonds	5,452,392,642
Others	905,508,575
Risk Situation	
Outstanding credits	60,830,704,818
Bad debts for 30 to 89days	1,872,307,102
Bad debts for 90 to 179days	1,221,317,608
Bad debts for 180 to 364days	1,296,174,115
Bad debts more than one year	464,434,434
Gross total credits	68,216,060,149
Provision for bad debts(built-up)	4,301,248,053
Credits by activity sector	63,392,949,171
Agriculture, Livestock & Fishing	11,728,569,322
Number of debtors(Natural persons)	15,889
Number of debtors(Legal entities or groups)	1,425
Number of debtors from legal entities or groups	42,634
Total number of people concerned in credits	60,211
Public works, buildings & housing	22,807,784,941
Number of debtors(Natural persons)	16,215
Number of debtors(Legal entities or groups)	323

Number of debtors from legal entities or groups	12,870
Total number of people concerned in credits	30,937
Trade, Restaurants & Hotels	13,705,779,703
Number of debtors(Natural persons)	12,312
Number of debtors(Legal entities or groups)	1,072
Number of debtors from legal entities or groups	11,321
Total number of people concerned in credits	36,066
Transportation, Warehousing & Communication	3,469,980,287
Number of debtors(Natural persons)	2,420
Number of debtors(Legal entities or groups)	71
Number of debtors from legal entities or groups	1,091
Total number of people concerned in credits	3,739
Others	11,680,834,918
Number of debtors(Natural persons)	32,662
Number of debtors(Legal entities or groups)	4,489
Number of debtors from legal entities or groups	87,700
Total number of people concerned in credits	122,964
Outstanding credit volume granted to managers	184,412,563
Outstanding credit volume granted to employees	586,075,067

Net fixed assets	5,703,034,847
Other assets	12,644,839,876
Total deposits	67,923,002,856
Demand deposits	52,777,182,058
Time Deposits	14,595,537,952
Others	550,282,846
Liability subsidies	291,691,059
Borrowings	1,196,704,590
Other liabilities	10,172,011,617
Equity Capital:	17,418,173,464
Share capital	4,315,778,328
Reserves	4,091,890,524
Retained Earnings	254,772,354
Equity capital subsidies	7,027,154,845
Net earnings	1,728,577,413
Interest Income	9,727,719,408
Provision adjustment of bad debts	1,139,690,669
Other income	3,949,309,067
Provision for bad debts	3,934,729,270

Employee salaries	3,966,423,006
Other operating expenses	5,944,886,878
Received Subsidies	183,823,084

Source: NBR Supervision Report 1995 - 2007

By end of 2006 there were 223 microfinance institutions across the country with total assets equivalent to 177million dollar. 62% of the assets were on credit, total deposits made 69% of the total assets. This means that most of the Microfinance Institutions' assets are to cover liabilities leaving no reserve for *investments*. Some of the outstanding credits belong to employees while other funds were provided for bad debts. This means that most of the Microfinance Institutions' funds acquired in form of grants, donations, commercial borrowings and interest income are fully deployed for funding of loan applications and operational expenses.

Table 1.2: Rwanda Microfinance Institutions consolidated financial *situation as at 31/12/2008(Rwf' in billions)*

ITEMS	31/12/2007	%VARIANCE	31/12/2008
Total assets	47.940	27.1	60.950
Total deposits	28.670	36.6	39.156
Loans(gross amount)	27.390	54.2	42.224
Non-performing loans	2.254	0.2	2.259
Provisions	1.476	-23	1.136
Loans (net amount)	25.914	58.6	41.088

Cash(on hand and held in banks)	10.851	-7.2	10.065
Equity(Subsidies included)	12.022	39.2	16.731

Source: NBR Report 2008

From year 2007 to 2008, total assets of microfinance increased by 27.1%, gross loans by 54.2%, total deposits by 36.6%, while provisions decreased by 23%, cash on hand and at the bank by 7.2% and non-performing loans by 0.2%. This indicates that portfolio and source of funding of microfinance institutions increased progressively but liquidity rate and non performing loans continued to deteriorate.

Table 1.3: Rwanda Microfinance Institutions consolidated financial situation as 31/12/2010 (Rwf' in billions)

Million Rwf	2009	2010	% Change
Total Assets	36.06	45.28	25.6
Cash and cash equivalent	8.58	9.40	9.5
Gross loans(before provisions)	24.72	33.61	36.0
Non-performing loans(before provisions)	2.87	3.76	30.9
Provisions	1.28	1.89	47.3
Loans(Net of provisions)	23.44	31.72	35.3
Deposits	19.10	23.90	25.1
Equity	11.96	15.67	31.1
Non-performing loans rate	11.6	11.2	-3.4

Liquidity rate	68.8	59.3	-13.8
Capital Adequacy (solvency)	33.2	34.6	4.2

Source: NBR Report 2010

From year 2009 to 2010, total assets of microfinance increased by 25.6%, gross loans by 36.0%, total deposits by 25.1%, provisions by 47.3%, cash and cash equivalent by 9.5% while non-performing loans rate decreased by 3.4% and liquidity rate by 13.8%. As portfolio and total assets of Microfinance Institutions continued to increase year by year, non performing loan rate started declining but liquidity rate deteriorated further.

2.3 Internal Controls

Microfinance Institutions to regulate themselves require independent boards, well formulated and properly implemented internal controls and risk management policies, and highly quality auditors who are clearly independent of the boards themselves (Kenneth & Tazul, 2005).

Microfinance Institutions need to develop internal controls to address security risk when providing voluntary savings products. There is extensive knowledge in the formal financial sector that addresses risk, including such checks and balances as dual custody of cash and combinations, separation of duties, audit trails, and the use of fireproof vaults and drop boxes (Ledgerwood, 2000).

Ledgerwood(2000) expressed that Weak or nonexistent internal control procedures create an environment in which fraud can be prevalent. Many Microfinance Institutions do not have an internal audit function and their external auditors do not even visit branches, much less confirm client balances. When an MFI experiences rapid growth, it is difficult to cultivate the depth of integrate that is required among staff members and for internal control practices to keep pace.

Due to weak internal control systems in Microfinance Institutions, Directors and employees are given high amounts of loans that are unable to pay. This is clients' time and demand deposits that are misused that leads them to bankruptcy. Loans are given to clients with no established business and collateral securities which raises the non-performing loan rates. Accounting information system and credit monitoring is so poor and this forms part of the internal control systems (National Bank of Rwanda Report, 2007).

2.4 Credit Monitoring Systems

Credit Officers make frequent visits to clients to ensure that clients are maintaining the business and intend to repay the loan. Frequent visits allow the credit officers to understand the clients' business and the appropriateness of the loan. Visits also contribute respect between them as credit officers understand the challenges the business is currently facing and clients' commitment to their work (Ledgerwood, 2000).

While well established accounting practices are reflected in general ledger software, there are currently no standards or widely accepted guidelines for the loan tracking side of the management information system. A portfolio system should be designed to work with all major types of financial products that are currently offered. A system should be developed to track different types of products offered like working capital loans, fixed asset loans, small business loans and solidarity group loans. Information like interest rates, interest calculation methods, maximum allowable amounts and terms, definition of the overdue payments, eligible collateral and many other factors will be tracked. The report design should be able to capture information relating to portfolio quality by individual loan officer, by branch office, by region, or by overall institution. Frequency and timelines and performance indicators are some of the examples of Microfinance Institutions quality reports (Ledgerwood, 2000).

In the report of the National Bank of Rwanda of 2006 indicated that the significant losses of Microfinance Institutions that led them to bankruptcy were partly caused by poor management of credit files.

2.5 Products and Services

Products are financial intermediaries which involve the transfer of capital or liquidity from those who have access at a particular time to those who are short at that same time. Since production and consumption do not take place at the same time, finance in the form of savings and credit arises to permit coordination. Savings and credit are made more efficient when intermediaries begin to transfer funds from firms and individuals that have accumulated funds and are willing to shed liquidity to those that desire to acquire it (Ledgerwood, 2000).

Services are the processes of building human and capital required by sustainable financial intermediation for the poor. The range of services and products commonly provided by Microfinance Institutions are credit, savings, insurance, payment services, social intermediation, enterprise development services, and social services (Ledgerwood, 2000).

Credit is borrowed fund with specified terms for repayment. Loans are generally made for productive purposes like generating revenue within a business. Most common sectors financed by Microfinance Institutions include agriculture, Livestock and Fishing, Public works, buildings and housing, trade, Restaurants & Hotels. However some Microfinance Institutions provide loans for consumption, or special occasions. While many Microfinance Institutions insist that only productive loans be made, any loan that increases the liquidity of the household frees up enterprise revenue which can be put back into the business. Most Microfinance Institutions strive to reach sustainability by ensuring that the services offered meet the demands of clients, that operations are as efficient as possible and costs are minimized, that interest rates and fees are sufficient to cover costs, and that clients are motivated to repay loans. Microfinance Institutions can be sustainable providing they have enough funds to continue operating in the long term. These funds can be obtained solely through operational revenue or through combination of donations, grants and operating revenue (Ledgerwood, 2000).

Credit is generally divided into two broad categories of individual and group approaches based on how the MFI delivers and guarantees its loans. Individual loans are delivered to individuals based on their ability to provide the assurance of repayment and some level of security.

Group based approaches make loans to groups that are either to individuals who are members of the group and guarantee each other's loans or to groups that then sub-loan to their members (Ledgerwood, 2000).

To design a loan product to meet borrower needs, it is important to understand the cash patterns of the borrowers. Cash in flows are the cash received by the business or household in form of wages, sales revenue, loans or gifts; cash outflows are the cash paid by the business or household to cover payments or purchases. Lenders must ensure that borrowers have sufficient cash inflow to cover loan payments when are due. Some cash inflow and outflow occur on a regular basis, others at irregular intervals or on an emergency or seasonal basis. Loans are based on the cash patterns of borrowers and designed as much as possible to enable the client to repay the loan without undue hardship. This help MFI avoid potential losses and encourages clients both to manage their funds prudently and to build up an asset base (Ledgerwood, 2000).

The World Bank's "worldwide inventory of microfinance institutions" found that many of the largest, most suitable institutions in microfinance rely heavily on savings mobilizations. Deposits provide a highly valued service to the world's poor who seldom have reliable places to store their money or the possibility to earn a return on savings (Ledgerwood, 2000).

Compulsory savings represent funds that must be contributed by borrowers as a condition of receiving a loan, sometimes as a percentage of the loan or a nominal amount. For the most part compulsory saving can be considered part of a loan product rather than actual savings product, since they are so closely tied to receiving and repaying loans. However, compulsory savings are often perceived by clients as a fee they must pay to participate and gain access to credit. Generally compulsory savings cannot be withdrawn by members while they have loan outstanding. Clients are not able to use their savings until their loan is repaid (Ledgerwood, 2000).

Voluntary saving services are provided to both borrowers and non borrowers who can deposit or withdraw according to their needs. Interest rate paid range from relatively low to slightly higher than those offered by formal financial institutions. The requirement of compulsory savings and the mobilization of voluntary savings reflect two different philosophies. The former assumes the poor must be taught to save and that they need to learn financial discipline. The latter assumes that the working poor already save and that what is required are institutions and services appropriate to their needs (Ledgerwood, 2000).

Microfinance Institutions lending programs offer insurance or guarantee scheme. Each member is required to contribute a certain percentage of the loan amount to an insurance fund. In case of the death of a client this fund is used to repay the loan and provide the deceased client's family with the means to cover burial costs (Ledgerwood, 2000).

In traditional banks payment services include check cashing and check writing privileges for customers who maintain deposits. In addition to this they make transfers and remittances of funds from one area to another. Payment services are bundled with savings services (Ledgerwood, 2000).

Social intermediation is defined as an effort to build the institutional capacity of groups and invest in the human resources of their members so that they can begin to function more on their own with less help from outside. Microfinance Institutions simply focus on developing group cohesiveness to ensure that members continue to guarantee each other's loans and benefit as much as possible from networking and the empowerment that comes from being part of a group. Social intermediation mostly involves training group members in participatory management, accounting, and basic financial management skills and helping groups to establish a good record keeping system (Ledgerwood, 2000).

Enterprise development services including Marketing, technology services, business training, production training, subsector analysis and interventions (Ledgerwood, 2000)

Some Microfinance Institutions have chosen to provide social services in addition to financial intermediation. Such social services include training on health, nutrition, education and literacy. This helps MFI to take advantage of contact with clients during loan disbursement and repayment (Ledgerwood, 2000).

2.6 Beneficiary selection criteria

Generally, Microfinance Institutions lend to low-income clients who often have very few assets. Innovative means of reducing the risk of loan loss includes collateral substitutes and alternative collateral. Collateral substitutes include peer pressure either on its own or jointly with group guarantees. Some Microfinance Institutions lend to people based on a good reputation in the community. Many Microfinance Institutions facilitate the formation of groups whose members jointly guarantee each other's loans. Guarantees are either implicit or actual with group members liable if other group members default on their loans (Ledgerwood, 2000).

Credit delivery is divided into the two broad categories of individual and group approaches based on how the MFI delivers and guarantees its loans. Individual loans are delivered to individuals based on their ability to provide the MFI with assurances of repayment and some level of security. Group based approaches make loans to groups that is either to individuals who are members of a group and guarantee each other's loans or to groups that then sub loan to their members (Ledgerwood, 2000).

Individual lending models include screening of potential clients by credit checks and character references, tailoring of the loan size and term to business needs, frequent increase over time of the loan size and term, efforts by the staff to develop close relationships with clients so that each client represents a significant investment of staff time and energy (Ledgerwood, 2000).

Group lending involves the formation of groups of people with common wish to access financial services. Group lending models include solidarity groups which facilitate the formation of relatively small groups of 5 to 10 people and make individual loans to group members. Group based lending use peer pressure as a substitute for collateral. Group lending targets very poor people who can't meet the traditional collateral requirements of financial institutions. Typically, loan officers do not deal with individual group members but rather collect repayment from a group or village leader thereby reducing transaction costs (Ledgerwood, 2000).

Delia (2011) stipulated that Individuals and small business enterprises (SME) are selected according to their financial standing and the operational capability.

2.7 Geographical area and target group

Ledgerwood (2000) said that Microfinance Institutions provide financial services to both rural and urban centers targeting a large number of poor households and individuals with small or non business set up. Providing financial services to rural clients is more effective means of reaching a large number of poor households. Providing services to populations that are widely dispersed incurs greater transaction costs while densely populated areas are harder to service. Some Microfinance Institutions lend to people based on a good reputation in the community. Prior to making a loan, the credit officer visits various establishments in the community and asks about the potential client's character and behavior.

Christen et al. (2004) reports an astonishing 500 million people served, mostly with savings accounts while the Microcredit Summit in their 2006-meeting in Halifax Canada celebrated the milestone of 100 million borrowers reached. Nevertheless, microfinance still only reaches a fraction of the world's poor (Robinson, 2001& Christen et al., 2004). Additionally, there is a special challenge related to reaching poorer segments and people living in less densely populated areas (Helms, 2006, Johnson et al., 2006). Altogether, there is a recognized supply challenge in the market, which indicates that there is a need for more knowledge about factors that influence the performance and outreach of microfinance suppliers (Roy, 2009).

2.8 Interest rate

Generally microfinance clients are not interest rate sensitive, that they don't borrow more or less in reaction to an increase or decrease in interest rates. For the most part, an interest rate far above commercial bank rates is acceptable because the borrowers have such limited access to credit. Microfinance Institutions determine interest rate they need to charge on loans based on their cost structure which includes financial costs, operating costs, loan loss provision, and cost of capital.

There are two common methods used to calculate interest rate on a loan, declining balance method and flat method. Declining balance method calculates interest as a percentage of the amount outstanding over the loan term while flat method calculates interest as a percentage of the initial loan amount.

To determine the effective rate of interest considering all financial costs of a loan, including the time value of money, compulsory savings, and contributions of other funds, the internal rate of return method is used. The IRR is defined as the specific interest rate by which the sequence of installments must be discounted to obtain an amount equal to the initial credit amount (Ledgerwood, 2000).

2.9 Non-performing loan rate

This is a rate of unpaid loans to total granted loans. It measures the performance of funded projects. According to National Bank of Rwanda report (2008) non-performing loans dropped from 25.01% in 2006 to 12.6% in 2008. However in 2009 the rate increased to 13.1% due to inflation rate and global financial crisis and economic instability. On a consolidated basis the rate again dropped to 11.2% in 2010.

When a client is unable to repay the loan due to illness, disaster, mismanagement, or some other crisis, it is appropriate to reschedule or refinance the loan. Refinancing refers to providing an amount of loan funds in addition to the original amount to allow the client to begin making the loan repayment (Ledgerwood, 2000).

2.10 Loan size

The appropriate loan amount is dependent on the purpose of the loan and the ability of the client to repay the loan. Often Microfinance Institutions have a maximum loan size for first time borrowers, which increases with each loan to enable client to develop a credit history and an understanding of the responsibilities associated with borrowing. There are two kinds of loans:

working capital loans and fixed asset loans. Working capital loans are for the current expenditures that occur in the normal course of business. It refers to the investment in current or short term assets to be used within one year. Examples include carpentry, food, goods purchased for market selling. Fixed asset loans are those made for the purchase of assets that are used over time in the business and have lifespan of more than one year. A loan of the fixed asset is bigger than working capital loan (Ledgerwood, 2000).

Note: The previous researchers discussed more on products, services and *funding mechanisms but did not see the aspect of financial stability in terms of* income general and future prospect of the microfinance institutions. This was the researchers' knowledge gap and by use of the primary data researcher has *provided information on level of income and recommendations.*

CHAPTER THREE
RESEARCH METHODOLOGY

3.0 Introduction

This chapter shows a set of methods and principles that were used when carrying out a studying on governance and performance of microfinance institutions. It includes a description of the research design, and data gathering procedures and measuring instruments. It describes the way in which data was collected and analyzed, procedures that were used to investigate the relationship of governance and performance in management of microfinance institutions. This chapter presents several sub-sections presented in the following order: Research design, population and sampling, target and accessible population, sample, sampling techniques, data collection, instrumentation, research procedure, quality control, validity, reliability, data analysis, assumption and limitations, and ethical consideration.

3.1 Research design

This study was conducted through descriptive design. The research design employed both qualitative and quantitative analysis to draw conclusions on dependent and independent variables collected from primary and secondary data by use of questionnaires, published reports and text books. The study was descriptive in nature because it involved data that are not readily quantifiable. Quantitative data was collected to determine the percentages and frequencies.

3.2 Population and Sampling

The total population of study was 115 employees of Vision Finance Company SA both Kigali and provinces.

3.2.1 Target/ Accessible population

Researcher targeted a population of 115 employees from Vision Finance Company S.A. The population was targeted using purposive method to be able to reach the employees with knowledge and information of the operation of Vision Finance Company SA. The population consists of male and female who are able to read and write and can access Vision Finance Company information.

3.2.2 Sample

Out of 115 employees, 91 were sampled using SLOVIN'S formula to calculate sample size from the population as indicated below. The purpose of this sample size was to reach at majority of employees making 79% of the population so that the data collected and analyzed can represent the whole population.

SLOVIN's formula is written as:

n = N / (1 + Ne^2)

n = Number of samples

N = Total population

e = Error tolerance

n=?

N=105

e=0.05

115/1+(115*0.05*0.05)

=115/1+(115*0.0025)

=115/1+0.2625

=115/1.2625

=91.08

=91 sample size

3.2.3 Sampling Techniques

Researcher used purposive sampling method to target male and female employees of VFC who can be able to read and write and give them equal chances of participation. This technique was used to select the accessible population from the target population. Since both respondents were assumed to have the same knowledge and institutional information access, a number of respondents were selected in departments both at the main and branch offices based on knowledge and know how.

3.3 Data Collection

Researcher collected both primary and secondary data by use of research instruments which involves questionnaires, published reports and text books. A written set of questions were given directly to the selected sample to gather information about the study. Analysis of written materials from published reports, textbooks, and journals was done and findings presented to backup the analysis of questionnaires responses.

3.3.1 Instrumentation

Structured self administered questionnaires were developed. They had both closed open ended questions to capture answers from various sources of information. Researcher targeted literate employees who know the functioning of the organization and can be able to deliver their ideas well. Structured self administered questionnaires were used simply to give freedom to the respondents to share information that would not have been shared if interviewed. Questionnaires were developed based on the research objectives and secondary data.

3.3.2 Research procedure

Research information was collected through use of self administered questionnaires, consultation of relevant text books, handbooks, journals and reports from both microfinance institutions and governments. The developed questionnaires were distributed and administered to sampled employees of VFC both at the head office and in the branch offices around the provinces of the country. The study was both qualitative and quantitative in nature. Through use of well developed questionnaires, the researcher probed the respondents with a planned sequence of questions which were asked for in-depth information, data collected, analyzed and interpreted to generate the findings.

3.4 Quality Control

It refers to the validity and reliability of research instruments. It is an operational techniques and activities that are used to fulfill requirements for quality. Quality control prevents undesirable changes being present in the quality of the data being collected. Researcher controlled the quality of the data through use of a well developed questionnaires based on the research objectives. Similar information from the questionnaires were grouped, compared and tabulated for analysis and conclusions.

3.4.1 Validity

To control the validity of data, researcher developed a clear and understandable questionnaire, structured qualitative and quantitative questions based on the research objectives were asked to purposively selected respondents based on the literate from the Vision Finance Company. Through administering questionnaires information was collected and analyzed by use of grouping similar answered questions. To avoid cheating and copying of information, respondents were asked to answer the questionnaire individually and away from one another.

3.4.2 Reliability

In sampling procedure, majority of Vision Finance Company employees were sampled to represent the whole population. All literate employees were targeted to give reliable responses that were based on to draw the conclusions. Questionnaires were developed based on the research objectives as well as the collected literature information. Number of questions ware closed ended for easy responses, comparison and analysis. Responses were administered to avoid cheating and get reliable information.

3.5 Data Analysis

Bailey (1978:321) stated that not all data can be presented in their entirety. Variables that are central to the goals of study are to be analyzed. Following this study the research used inferential analysis to draw conclusions concerning the relationships and differences found in research results. A researcher used the sample statistics to draw conclusions about the population from which the sample was drawn. The relationships and differences of collected data by use of questionnaires were analyzed, errors eliminated and results correlated and presented in tables. Interpretation and Conclusions were drawn from sample results to represent the entire population.

3.6 Assumptions and Limitations

This study focused on the governance and performance of microfinance institutions in Rwanda. However a case study was carried out in Vision Finance Company as one of the major microfinance institution in Rwanda since 2000. The primary data was entirely collected from the VFC but the secondary data was collected from the various books of microfinance institutions and the reports about the performance of microfinance institutions in Rwanda. In governance and performance issues, the study didn't collect data about staff motivation and remuneration. Issues about capacity building, productivity and quality of reports were not tackled. No data was collected from microfinance institutions clients to ascertain their level of happiness about the services provided.

Language barrier to some of the respondents was a challenge. Questionnaires were to be filled during working hours which is time for organization work. Many times the researcher was required to go back again and again with a lot of persuasions. Some respondents were French speaking with little knowledge in English and could require interpretation of some sentences and words. To overcome the challenge of language barrier to some of the respondents, researcher interpreted questions and requested them to either answer in French or Kinyarwanda. On the time management, research used General Manager of Vision Finance Company to allow the employees to take time and fill the questionnaires and since Vision Finance Company is a Microfinance of World Vision Rwanda from which the researcher is an employee the exercise was simple.

3.7 Ethical Consideration

This is the moral justification of the research or investigation. Researcher got clearance from Vision Finance Company to access its books and reports and collect primary data from its staff. The institution was much interested because it will use research results to revisit some of its policies and procedures and deal with some governance and performance challenges. Before the data was collected all respondents were informed about the purpose of the research and its benefits to the researcher as well the institution. Privacy and confidentiality was guaranteed to them and the researcher assured them that the information provided will be confidential. Respondents were given liberty to provide the information and no one was coerced or intimidated to do so.

Privacy and Confidentiality

Researcher assured the respondents that information collected was for academic purpose and will not be revealed to any other person without their consent. Questionnaires were open and closed ended that saves time and energy and can easily be interpreted by respondents.

Anonymity

All respondents in the research study remained anonymous and were assured that their individual identities were not a salient feature in the research. This was done by researcher explaining to them the purpose of the study and evidence of conducting the research.

Researcher's Responsibility

A researcher was sensitive to human dignity and focused on research work rather than on the respondents.

Informed Consent

Respondents were explained on the purpose of the research study and its benefits on Vision Finance Company. Upon these explanations, respondents were freely participated in the research work.

CHAPTER FOUR
DISSCUSIONAND AND PRESENTATION OF FINDINGS

4.0 Introduction

Collected data were presented, analyzed and interpreted according to research objectives. Presentation was in form of statistical tables, figures and percentages explained to answer the research questions. Data were collected from Vision Finance Company through administered questionnaires. This is in response to the research topic "Governance and Performance of Microfinance Institutions in Rwanda".

4.1 Analysis and Interpretation of Data

Analysis and Interpretation of data is in two categories according to designed questionnaire: Identification of the respondents and questions related to the research topic. The identification of respondents is comprised of age, sex, education background, working experience, Job title and office location. This is done to ensure that relevance and reliable responses are obtained.

4.1.1 Identification of Respondents

Table 4.1: Response rate

Respondents	Frequency	percentages
Responses	70	77
Absent	21	23
Total	91	100

Source: primary data

Out of 91 employees sampled 77% filled questionnaires correctly and their data were analyzed and presented for findings and conclusions. Researcher could not get back 23% of the questionnaires distributed due to different reasons. Some employees were on leave, sick and others were out of the country.

Table 4.2: Age of respondents

Age group	Frequency	percentages
18-30	38	54
31-40	20	30
41-45	6	8
46-55	6	8
Above 55	0	0
Total	70	100

Source: primary data

The highest percentage of respondents ranges from 18 to 30years. This means that the majority of respondents were in youth group. 54% of the employees are youth, energetic and adaptable to changing technology and environment.

Table 4.3: Respondents by Gender

Sex	Frequency	Percentages
Male	39	56
Female	31	44

Total	70	100

Source: primary data

Responses obtained indicated 56% were male and 44% female. This means that Vision Finance Company is gender sensitive as per the government policy.

Table 4.4: Educational Level

Education Level	Frequency	percentages
Advanced certificate	16	23
Higher Diploma	8	12
Bachelor's Degree	45	63
Masters degree	1	2
PhD	0	0
Total	70	100

Source: primary data

Educational level indicated that 63% of the respondents had bachelor's degree, followed by advanced certificate with 23%. This means that Vision Finance Company employees secondly level staff for junior work and university graduate at middle high positions. This means that like other organizations, Vision Finance Company delivers quality service to their clients.

Table 4.5: Work Experience

Number of years	Frequency	Percentage

Less than 1year	19	27
1-2	11	16
2-3	6	8
3-4	0	0
Above 5years	34	49
Total	70	100

Source: primary data

In terms of experience, 49% of the respondents had professional experience and able to provided the required expertise in delivering service to the clients. This means that Vision Finance Company provides good management and fair salary as part of the staff retention.

Table 4.6: Job Title

Position	Frequency	Percentage
Managing Director	1	1
Division Director	0	0
Departmental Manager	8	11
Sector Manager	8	11
Branch Manager	3	5
Officer	30	43
Accountant	17	24

Auditor	0	0
Cashier	3	5
Total	70	100

Source: primary data

Majority of the respondents making 43% are officers that make up the middle class of the employees who on a day to day interacts with the clients on loan disbursement and management. This is strengthening of the middle managers to be able to provide the required service to the clients.

4.1.2 Research Related Questions

To be able to achieve research objectives, questions relevant to research study were asked. Data were analyzed, interpreted and presented according to the sequence of research objectives. The first objective of this study was to ascertain financial stability of microfinance institutions and the nature of products and services provided to their clients. Results obtained were presented as follows:

Table 4.7: Funding portfolio

Type of funding	Frequency	Percentage
Grants and donations from donor agencies	21	30
Borrowings from banks and other commercial sources	9	13
Investments and interest income from VFC operations	18	25
Client savings and deposits	14	21

From the three sources mentioned above	8	11
Total	70	100

Source: primary data

Microfinance institutions in Rwanda have four major source of funding to their operations. The two major ones are grants and donations and interest income from investments. For them to be stable financially, they should work as banks and invest more in increasing deposits and create more loans that will increase interest income.

Table 4.8: Income Level

Source of Income	Percentage
Grants and donations from donor agencies	17
Borrowings from banks and other commercial sources	20
Investments and interest income from VFC operations	52
Client savings and deposits	11
Total	100

Source: primary data

From the income level, 48% of their funds comes from outside while 52% is generated as interest income. Outside funds are not guaranteed and can be withdrawn at any time. It is recommended that microfinance institutions invest not only in loans but also in other quick assets like commercial papers, and treasury bills. The second largest income is borrowings which mean that the cost of capital is high and risk to their operations.

Microfinance institutions in Rwanda provide a range of products and services to their clients as summarized in the table below:

Table 4.9: Products and Services

Type of products & Services	Frequency	Percentage
Shorter and Longer term loans	18	25
Banking of savings and deposits	21	29
Insurance scheme to the loaned funds	12	18
Payment services through checking accounts	5	7
Training on participatory management, book keeping and accounting	11	17
Training on health, nutrition, education and literacy	3	4
Total	70	100

Source: primary data

From the statistics above there are two main products and services provided by microfinance institutions in Rwanda. These are banking of savings and deposits, and shorter and longer term loans. However, they provide other services as described in the table above. Payment through checking accounts is still limited and this would increase deposits if strengthened. Deposits create assets that would generate more income to Microfinance Institutions.

The second objective of this study was to establish how Microfinance Institutions select clients in loan applications. Results obtained were presented as follows:

Table 4.10: Beneficiary selection criteria

Selection criteria	Frequency	Percentage
Capacity of repayment	22	31
Collateral	17	25
Business Existing	9	13
Credibility	11	16
Business location	3	4
Local government recommendations	1	2
Age	7	9
Total	70	100

Source: primary data

From the data above, it is observed that Microfinance Institutions use two major criteria in analyzing and selecting viable projects or applications. These are Capacity of repayment and collateral. Capacity of repayment includes applicant cash flows in terms of the salary earning or any other existing business of high cash flows. Collateral are the existing physical assets that can easily be converted into cash. Other considerations are in terms of honest and credibility of the clients. These selection criteria are similar to commercial banks and recommended by the national bank.

The third objective of this study was to identify the internal controls and credit monitoring systems applied by Microfinance Institutions in loan recovery. Results obtained were presented as follows:

Table 4.11: Management Committees

Committees	Frequency	Percentage
Audit Committee	39	56
Risk Management Committee	11	16
Governance Committee	14	20
Procurement committee	3	4
H&R Committee	3	4
Total	*70*	*100*

Source: primary data

The tabulated data indicates that Microfinance Institutions have five management committees of which three are more functional than others. These are audit committee, risk management committee, and governance committee. They are so useful in management and control of the operations.

Table 4.12: Written Manuals

Manuals	Frequency	Percentage
Personnel	11	16
Operations	18	26
Credit policies and Procedures	13	19
Audit	6	7
MIS	10	15

Accounting	9	14
Code of Conduct & dressing	1	1
Asset & Liability Management Manual	2	2
Total	70	100

Source: primary data

Statistical information indicates that Microfinance Institutions have a number of written manuals to guide the governance and performance. However, the most common used are personnel, operations, credit policies and procedures, MIS, and accounting. These manuals are so important in stating the internal controls and procedures of the operation and fostering in the code of conduct of the personnel.

Table 4.13: Audit practices

Audits	Frequency	Percentage
Employs services of an External Auditor	19	27
External Audit is part of compliance to regulators requirements	18	26
Internal Audit system in place	19	27
A unit or a full-time staff is in charge of Internal Audit	10	14
Internal Audit in the branches was regular in the last 12 months	4	6

Total	70	100

Source: primary data

The audit data in the table indicates that Microfinance Institutions employs both external and internal audit functions. The external audit is part of the stringent requirements of the national bank. The functioning of the internal audit department is not strong as it cannot regularly carry out audit functions through pout the year. The overall information indicates that there is an enforcement of internal control compliance in the management of Microfinance Institutions in Rwanda.

Table 4.14: Internal Audit functions

Audit functions	Frequency	Percentage
Cash counts petty cash fund	7	10
Spot checks bank books and ledgers	7	10
Spot checks meetings of groups	4	7
Checks if accounting procedures are followed	8	11
Checks if loan releasing procedures are followed	5	7
Checks if loan documents and requirements are followed	8	11
Checks if administrative procedures are followed	5	7
Spot checks if reports are accomplished correctly	5	7
Verifies loan transactions with sample borrowers	7	10
Spot checks if collections are deposited in the bank	7	10

Reconciles deposit slips with collection report	7	10
Total	70	100

Source: primary data

The audit function data indicates that a number of books check is done to make sure that assets are safeguarded and calculation of liabilities is correct. It is an enforcement of the compliance of policies and procedures in all dealings and operations.

Table 4.15: Management Information System

Data collected	Frequency	Percentage
Number of loans disbursed	6	8
Amount of loans disbursed	7	9
Number of loans outstanding	6	8
Amount of loans outstanding	4	7
Amount of loans repaid	6	7
Amount of loans in arrears	4	6
Aging of loans in arrears	3	5
Portfolio at risk	6	8
Number of active borrowers	4	6
Number of CBU/Savers clients	3	5
Amount of CBU/Savings generated	3	5
Balance sheet	3	5

Income and expense statement	3	5
Number of male clients	6	8
Number of female clients	6	8
Total	70	100

Source: primary data

MIS collects a number of information ranging from loan disbursement to repayment, active borrowers, savers and gender and finally income and balance sheet accounts. The system tracks defaulters and provides fund for bad debts. Causes of bad debts includes business failure due to mismanagement or environmental changes, fraud, use of loan for unspecified projects, poor analysis of loan applications, and jobless.

CHAPTER FIVE
SUMMARY OF FINDINGS, CONCLUSIONS, AND RECOMMENDATIONS

5.0 Introduction

This chapter deals with the summary of the major research findings, general conclusions and recommendations that would enhance a meaningful and a clear link between governance and performance of microfinance institutions in Rwanda. Research findings were based on research questions while research objectives formed major guiding principles in data analysis that led to conclusions and recommendations.

5.1 Summary of findings

Economic development was one of the pillars of the government of Rwanda in realizing its vision 2020. Establishment of microfinance institutions was a focus as a private sector that reaches at grass root level. Since 2003 a number of these institutions were established but a fraction of them collapsed especially in 2005 to 2007. To be able to determine the causes, research objectives were set up, primary and secondary data collected and analyzed through use of self administered questionnaires, reports and text books. The first objective of this study was to ascertain financial stability of microfinance institutions and the nature of products and services provided to their clients.

Both primary and secondary data indicates that microfinance institutions are largely financed by interest income, and borrowed funds from commercial and banking institutions. Other source of funds are donations and grants and to some extent client savings and deposits. However the borrowed funds from banks and other commercial services create a large liability to the institution which can lead to bankruptcy if not well managed. Rwanda microfinance institutions provides a number of products and services largely being the banking of savings and deposits followed by shorter and longer term loans ranging from three month to three years. Other services includes insurance scheme to the loaned funds, training on participatory management, book keeping and accounting. Training on health, nutrition, education and literacy is provided to selected individuals especially those with HIV/AIDS. It has been noticed that Rwanda microfinance institutions provides loans to variety of initiatives which are complex to manage. From 2007 to 2008 the loan amount increased by 59% causing a corresponding non-performing loan increase by 20%. From 2009 to 2010 the loan amount increased by 35% causing a corresponding non-performing loan increase by 31%.

The second objective of this study was to establish how Microfinance Institutions select clients in loan applications. Following secondary and primary data results, clients are selected according to ability or capacity of individuals or groups to repay the loans, existence of the already established microenterprises and collateral securities, credibility, business location, local government recommendations and the age of the applicant. Collateral securities involve physical assets as well as group guarantee.

The third objective of this study was to identify the internal controls and credit monitoring systems applied for loan recovery. Secondary and primary data indicates that Rwanda microfinance institutions have a number of written manuals to govern the functioning of microfinance institutions and these includes personnel, operation, accounting, management information systems manual, code of conduct and dressing, credit policy and procedures, asset and liability management manual. They employ external and internal audit functions as required by regulators. However it is indicated that the internal audit unit is not strong enough to regularly audit the books of both head office and branches. The number of documents checked gives assurance that if carried out risks can be mitigated.

The information collected in management information system include a number of information ranging from the amount of loan disbursed, repaid, and outstanding, in arrears, at risk and other relevant information for loan monitoring. They also have loan loss provision policy which gives 100% provision for past due loans of 180days and above. The interest rate per annum ranges from 24% individuals and 30% for groups.

5.2 Conclusion

According to research questions and findings discussed above, objectives of study were successfully achieved. The findings indicate that in the early years of 2005 to 2007 a number of Microfinance Institutions closed down due to governance issues ranging from high staff loans, high operating expenses, high non-performing loan rate, unstable income statement, negative net worth or low solvency ratio to the required minimum of 10%, and strong dependence to subsidies. However since 2008 to date only one MFI closed down indicating recovery in governance and performance of Microfinance Institutions due to efforts of national bank in supervision, monitoring and training. Enforcement of stringent requirements contributed much in tackling governance issues. This is shown by general increase in total assets, gross loans, total deposits, provisions and slight decrease of non-performing loan rate.

Internal control and monitoring systems of loans gives an assurance that the microfinance institutions are well managed. The funding portfolio of microfinance institutions largely depends on interest income, borrowed funds, donations and grants. Borrowed funds, donations and grants are not stable source of income and an alternative source of funding need to be established. Expenses and liabilities due to borrowed funds, personnel cost, and provisions take big portion of the microfinance budget. Therefore there is a need to reduce operating expenses especially interest on borrowed funds and personnel cost.

Products and services provided to clients are in line with government requirements but the criteria used to select the clients are similar to commercial banks especially for the individual loans and not targeting the poor people who are not able to access the commercial bank loans. This is contrary to government objective of establishing microfinance institutions to provide financial services to the poor people who are unable to provide collateral securities.

In terms of employment, staff have required level of education, knowledge and skills to provide services to the clients. Analysis of loan applications needs to be strengthened to minimize the level of non-performing loans and increase liquidity. The above findings indicate that the national bank of Rwanda provided sufficient supervision activities and stringent requirements for the operation of microfinance institutions.

5.3 Recommendations

According to theories examined, data analysis and findings, researcher gives the following recommendations:

Microfinance institutions are advised to invest more in liquidity assets like treasury bills and commercial papers and increase deposits by operating checking accounts to raise more funds for loans and increase interest income. Borrowed fund, donations and grants need to be minimized to reduce cost of capital and dependence on subsidies. These are not stable source of income.

Microfinance institutions require number of commissions on loan service and other fees for services. This charge is on top of interest rate on loans which ranges from 24% on individuals and 30% on groups. Commissions, service fee and interest rate are burden to loan seekers who are generally poor and unable them to pay regularly hence creating non-performing loans. Microfinance institutions need to revisit charges and interest rate policy according to ability of their clients.

The internal audit function of the microfinance institutions need to be strengthened in order to regularly audit the books of accounts and identify the risk areas especially the loan applications, disbursements and repayments.

National Bank of Rwanda should continue to provide more training on management of microfinance institutions and banking services especially in the areas of asset creation, analysis of loan applications, loan monitoring and marketing services. In turn microfinance institutions should provide more training to their clients in the areas of business management and accounting.

5.4 Further research

Research results indicate that governance and performance of microfinance institutions has been improved in since 2008. However the researcher could not be able to assess the impact on the lives of the clients of the microfinance institutions. Impact assessment need to be carried out.

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APPENDICE

APPENDIX I: RESEARCH QUESTIONNAIRE

TUMWINE VENANT

KAMPALA INTERNATIONAL UNIVERSITY

INSTITUTE OF OPEN AND DISTANCE LEARNING

COURSE: MBA FINANCE & BANKING

TEL: +250788586215

RESEARCH TOPIC: GOVERNANCE AND PERFORMANCE OF MICROFINANCE INSTITUTIONS IN RWANDA.

CASE STUDY: VISION FINANCE COMPANY

Dear Respondents,

You are highly requested to intimately participate in the research study entitled Governance and Performance of Microfinance Institutions in Rwanda.

This questionnaire seeks information about the governance and performance of microfinance institutions in Rwanda with particular focus on Vision Finance Company. Your participation in this study is completely voluntary and there are no foreseeable risks associated with it

The study is both for academic and public use only. Your questionnaire responses will be strictly confidential and data from this research will be reported in the dissertation anonymously.

Thank you very much for your time and support. I'm very grateful for your honest and cooperation in making this research successful.

God bless you

This questionnaire is composed of two parts that is to say part A&B

Part A is personal identifications where as B is made up of both closed and open ended questions for research purpose. So you are cordially required to answer the following questions provided to you by ticking one or more of the boxes provided below.

Part A: Respondents identifications

How old are you?

18- 30 ☐

31-40 ☐

41- 45 ☐

46-55 ☐

Above 55 ☐

What is your Sex?

Male ☐

Female ☐

What is your educational level?

Advanced certificate ☐

Higher Diploma ☐

Bachelor's degree ☐

Masters degree ☐

PhD ☐

Any other (specify) ……………………………………………………………

What is your work experience?

Less than 1year ☐

1-2 years ☐

2-3years ☐

3-4years ☐

Above 5years ☐

What kind of position do you have in the organization?

Managing Director ☐

Division Director ☐

Departmental Manager ☐

Branch Manager ☐

Sector Manager ☐

Officer ☐

Auditor ☐

Cashier ☐

Any other not mentioned above ………………

Which province is your office located?

Eastern province ☐

Western province ☐

Northern Province ☐

Southern province ☐

Kigali city ☐

What is the type of your office?

Main office ☐

Branch office ☐

Extension of the branch office ☐

Please name the office ………………………………

Part B: Questions related to Research topic

Where the organization does gets source of funding?

Grants and donations from donor agencies ☐

Borrowings from banks and other commercial sources ☐

Investments and interest income from VF operations ☐

Client savings and deposits ☐

From the three sources mentioned above ☐

Specify any other source not mentioned above ………………………..

What proportion of percentages do the above sources fall in if all of them are the organization source of funding?

Grants and donations from donor agencies ………………

Borrowings from banks and other commercial sources ……………..

Investments and interest income from VFC operations ………………

Client savings and deposits ....

Do you believe that the organization is sufficiently funded?

Strongly agree ☐

Agree ☐

Neither agree nor disagree ☐

Disagree ☐

Strongly disagree ☐

From the list below select the type of products and services VF offer to its *clients*?

Shorter and Longer term loans ☐

Banking of savings and deposits ☐

Insurance scheme to the loaned funds ☐

Payment services through checking accounts ☐

Training on participatory management, book keeping and accounting ☐

Training on health, nutrition, education and literacy ☐

What basic lending methodologies are you following?

Group lending ☐

Individual lending ☐

Village banking ☐

Others (please explain) ………………………….

Is Vision Finance Company registered?

Yes ☐

No ☐

Does Vision Finance Company have board of Directors?

Yes

No

How many members of the board of directors

1-2 ☐

3-4 ☐

5-6 ☐

7-8 ☐

Above 8 ☐

How often do board of directors met in a year? -------------

Which of the following committees do you have and how many members?

Audit Committee ☐

Risk Management Committee ☐

Governance Committee ☐

Others (please specify) …………………………..

For which of the following aspects of operation do you have a written manual?

Personnel ☐

Operations ☐

Credit Policies and Procedures ☐

Audit ☐

MIS ☐

Accounting ☐

Others (please specify) ………………………………….

What type of accounting system does your organization use?

Cash Basis ☐

Accrual Method ☐

What type of accounting software does your organization use?

Sun Systems ☐

QuickBooks ☐

Is your accounting system automated?

Yes ☐

No ☐

Which of the following practices does your organization follow in relation to *Audits*?

Employs services of an External Auditor ☐

External Audit is part of compliance to regulators requirements ☐

Internal Audit system in place ☐

A unit or a full-time staff is in charge of Internal Audit ☐

Internal Audit in the branches was regular in the last 12 months ☐

Does your internal audit include? ☐

Cash counts petty cash fund ☐

Spot checks bank books and ledgers ☐

Spot checks meetings of groups ☐

Checks if accounting procedures are followed ☐

Checks if loan releasing procedures are followed ☐

Checks if loan documents and requirements are followed ☐

Checks if administrative procedures are followed ☐

Spot checks if reports are accomplished correctly ☐

Verifies loan transactions with sample borrowers ☐

Spot checks if collections are deposited in the bank ☐

Reconciles deposit slips with collection report ☐

Others (please specify)………………………………………………………..

Please briefly describe any other internal control measures you practice

…………………………………………………………………………………………

…………………………………………………………………………………………

…………………………………………………………………………………………

…………………………………………………………………………………………

…………………………………………………….

Do you have a Management Information System?

Yes ☐

No ☐

What data do you collect in your system (manual or computerized)?

Number of loans disbursed ☐

Amount of loans disbursed ☐

Number of loans outstanding ☐

Amount of loans outstanding ☐

 ☐

Amount of loans repaid

Amount of loans in arrears ☐

Aging of loans in arrears ☐

Portfolio at risk ☐

Number of active borrowers ☐

Number of CBU/Savers clients ☐

Amount of CBU/Savings generated ☐

Balance sheet ☐

Income and expense statement ☐

Number of male clients ☐

Number of female clients ☐

For others, please specify ……………………………………………………………

What are the Eligibility Criteria you use in screening clients?

……………………………………………………………………………………………
……………………………………………………………………………………………
……………………………………………………………………………………………
……………………………………………………………………………………………
……………………………………………

Do you verify? If yes, how?

……………………………………………………………………………………………
……………………………………………………………………………………………
……………………………………………………………………………………………
……………………………………………………………………………………………
…………………………………………

How would you assess the screening process in terms of cost?

Very expensive ☐

Somewhat expensive ☐

Somewhat inexpensive ☐

Very inexpensive ☐

Others (specify) ……………………………………………………………

How would you assess the screening process terms of its effectiveness for *outreach*?

Very effective ☐

Somewhat effective ☐

Somewhat ineffective ☐

Very ineffective ☐

Others
(specify)……………………………………………………………………….

Please provide details on the loan terms and conditions:

LOAN TERMS AND CONDITIONS	Product 1	Product 2	Product 3	Product 4
Minimum Loan Amount to *individual*				
Minimum Loan Amount to a *group*				
Maximum Loan Amount to *individual*				
Maximum Loan Amount to a group				
Loan Purpose:				
Maturity (months)				
Interest Rate (indicate % per annum)				
Is Interest Rate -Based on Declining Balance -Add-on Interest computation -Others Specify__________				
Is Fees and Charges (% per				

loan or if in flat rate, specify amount)				
Fees and Charges -deducted from loan proceeds -not deducted, paid up front included in weekly/regular payments If others, please specify ___________				
Interest Paid(% per annum) Voluntary Savings CBU/Forced Savings				
Penalty Calculation Method: -Percentage of Amount Past due -Fixed amount - If others, please specify ___________				
Security /Collateral Required(Multiple Responses)				

Indicate if: -Pledge of an asset -Guarantee of an institution -Assignment of Standing crop -Post-dated cheque -Savings hold out -CBU(compulsory savings component) -Group guarantee - Others If others, please specify ___________				
Payment Mode Indicate if: -Daily -Weekly -Monthly -Quarterly - Others If others, please specify ___________				

Loan Collection Method -Group/Center Collection meeting - Individual Collection thru collectors -Deposit of Loan Payment to VFC depository bank account -Over the counter payment to VFC office -Others If others, please specify ___________				

What is your definition of a past due loan?

………………………………………………………………………………………………
………………………………………………………………………………………………
………………………………………………………………………………………………
………………………………………………………………………………………………
…………………………………

Have you experienced any late payment problems in the past 12 months?

………………………………………………………………………………………………
………………………………………………………………………………………………
………………………………………………………………………………………………

……………………………………………………………………………………………

………………………………….

What factors do you believe cause the late payment problems?

……………………………………………………………………………………………

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……………………………

What steps did your institution take to resolve these late payment problems?

……………………………………………………………………………………………

……………………………………………………………………………………………

……………………………………………………………………………………………

…………………….

Do you consider a loan at risk if one amortization payment is past due?

Yes ☐

No ☐

Based on your organization's standards, what do you consider as problematic loan?

Past due Ratio(ratio of unpaid to total loans issued) _______%

PAR(Standard rate) _____________%

Do you have a loan loss provision policy? That is, do you provide allowance for doubtful accounts and bad debts?

Yes ☐

No ☐

Please explain briefly your loan loss provision policy

………………………………………………………………………………………………

………………………………………………………………………………………………

………………………………………………………………………………………………

…………………………………………

Thank you for the your contribution in this research

END