Innovations

Success factors of the micro finance sector: evidence from the developing world using a success factor research approach

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Abstract

For the most part, the microfinance sector garnered notable success in the developing world in the past decades. This study identified and examined the extant literature in microfinance literature by way of success factor research approach. The success factor research approach has been championed in the past few decades in investigating organizational success factors. This approach is believed to provide the groundwork for reliable success factor research in the field of microfinance. This articulation of the key drivers of success among microfinance institutions (MFIs) could possibly lead to higher success of MFIs in diverse contexts. Accordingly, this study produced a humble finding regarding MFI success factors in the developing world - Asia, Africa, and South America, by systematically reviewing the extant literature in line with the subject of the study. Search and library sources were utilized in identifying published research works that focused on the success factors of MFIs in the specified regions. The result of this study show that, indeed, success factors vary across MFIs and their respective contexts. The identified success factors range from being innovative in choosing collaterals involving land title, bikes, motorbikes, cars, and cattle to ensure the sustainability of MFIs (Asia) to utilizing indigenous knowledge and resources in client screening and follow-up (Africa) to commercialization phenomenon (South America).In fact it is worthy to note that this study depended on the author's ability to access and review available resources, and this limitation could be taken as an avenue for future researchers to augment this by conducting further studies on MFIs' success factors from different contexts.

Key words *– 1.MFIs, 2.Success factors, 3.Asia, 4.Africa, 5.South America*

JEL Classification Code*: M20, M29*

Introduction

Microfinance is an alternative way for the poor to access affordable finance, relative to the traditional banking, and is the main source of financing for the world's unbanked and under banked population (Sun & Liang, 2021).Similarly, Aggarwal et al. (2015) noted that microfinance institutions (MFIs) have been widely shown to be an important global innovation as they have increased access to finance among the poorest, making major contributions to economic development. And it had experienced rapid growth in most developing economies (Ali et al., 2022) and they are considered as hybrid organizations with the dual mission of financial sustainability and social purpose (Lam et al., 2020). Besides, microfinance is seen as a crucial development tool, and it continues to grow in the developing world (Van Rooyen et al., 2012). The sector experienced a movement from socially oriented non profit microfinance institutions to for-profit microfinance (Cull et al., 2009); while still focusing on its prime goal of serving poor communities, it allowed millions of poor people around the world to receive loans and build up assets (De Aghion et al., 2007).

In other words, MFIs play decisive roles in transforming the lives of impoverished communities and they are considered as a special form of financial institutions as they have both a social nature and a for-profit nature (Gutierrez-Nieto et al., 2007). MFIs are very much beneficial to the society, especially to the poor and as a result they are widely regarded as bankers to the poor, and currently MFI's have extended their financial functions beyond lending to managing deposits (Tang, Quayes, & Joseph, 2020). MFIs are given a high regard and a considerable attention has been paid to the sector because it is a relevant participant in the formal financial system, whose target audience is people who are otherwise at risk of financial exclusion (García-Pérez, Fernández-Izquierdo, & Muñoz-Torres,2020).

Generally, MFIs have increasingly been positioned as one of the most important poverty reduction and local economic and social development policies in both developing and transition economies(Bateman & Chang, 2009). They are entities that offer loans and/or technical assistance in business development to low-income community in developing countries and exploring the success factors of these vital institutions is an intriguing area in microfinance literature (Hartungi,2007; Hulme and Mosley, 1996; Pinz, &Helmig, 2015). Doing so will normally help provide focus and clarity regarding the success factors of microfinance institutions in the developing world based on a systematic review of the existing evidence. Scholars from this field also substantiate that this approach provides the groundwork for dependable success factor research in the field of microfinance (Epstein& Crane, 2007; Pinz, &Helmig, 2015).

Statement of the problem

Since the inception of the Grameen Bank in Bangladesh, microfinance is considered as a successful tool for the mitigation of poverty in developing countries (Hulme& Mosley, 1996). And thus far MFI focused studies in the developing world; especially in Africa and Asia assert that micro finance programs do have favorable impact in transforming the lives of the poor (e.g. Chowdhury&Chowdhury, 2011; Pedrini et al., 2016). On top of that there are isolated studies that assessed the status as well as the success factors of MFIs in the developing world (Ahlin& Lin, 2006; Boateng, &Agyei, 2013; Lafourcade et al., 2005; Qayyum, & Ahmad, 2006). However, there is a dearth of studies in terms of providing a systematic review of the evidence regarding the success factors of MFIs from different contexts of the developing world. For example, Ahlin, Lin, and Maio (2011) asserted that there is lack of a systematic review of the evidence regarding the success factors of MFIs and the authors uphold that scholars should seek to show case the ingredients of MFI success factors in different settings. More so, despite its importance in the field of microfinance and management discipline, success factor research remains in a nascent stage in the field of microfinance and there is a growing importance of this research stream for scholars investigating MFIs (Pinz&Helmig, 2015). So, through systematic review of existing literature, this paper will exhibit success factors of MFIs in the developing world and this will fill the knowledge gap in the field as knowledge about MFI success factors is still scant (Mersland, Randoy, & Strom, 2011).

Research Objective and Question

This success factor research, which is becoming a popular research approach in organizational studies, investigated the success factors for microfinance institutions in the developing regions of the world – Africa, Asia, and South America. In doing so, the study addresses the research question - What are the success factors of microfinance institutions in the developing world? This is quite a relevant issue in success factor research as examining the primary determinants of success for microfinance institutions is intriguing and could lead to further develop the sector and achieve grander success by way of this research approach (Amberg, Fischl, & Wiener, 2005; Kieser& Nicolai, 2005).

Methodology

This section highlights the research approach of this study. First, it demonstrates how the literature search was performed, and then it outlines the idea behind the factor research method of doing research by way of describing the fundamental principle of success factor research, and finally, it explains the analysis technique that this study employed.

Literature Search

The focus of this success factor research was performing a systematic review of the evidence by referring to internationally-oriented published empirical research in the field of microfinance. This is a typical approach in success factor research by way of a systematic review of the evidence. To unearth the extant literature in the subject of this study published research works dealing with the success factor of MFIs and the references sections of all the pertinent articles were investigated for additional MFI success publications. Various search (e.gGooglescholar) and library resources (e.g. Addis Ababa University digital library) have been utilized to access the materials/publications.

Success Factor Research – the fundamental principle

The issue of why some organizations perform better than others (success factors) is a central matter in the field of organizational studies (Grunert, & Hildebrandt,2004; Hildebrandt, 1988; Van Rooyen, Stewart, & De Wet, 2012). And lessons taken from success are beneficial and if properly utilized they can further enhance organizational success in other contexts (Leidecker& Bruno, 1984). Generally, the success factor research approach has been established and popularized over the past few decades by a number of researchers (Amberg, Fischl, & Wiener, 2005). Success factors are understood as areas which ensure successful competitive performance of an organization (Rockart 1979). Examining MFI's success factors is described as enthralling as the sustainability of microfinance institutions (MFIs) remains essential due to the fact that they are providing financial services to low-income clients and the poor who are excluded from formal financial institutions (Fadikpe et al., 2022)

Analysis Approach

A success factor research approach with a qualitative content analysisprocedure is utilized in this study. The contents of published research works dealing with the success factors of MFIshave been reviewed and the success factors are identified and determined from the extant literature. This is in line with Hsieh and Shannon's (2005) idea that content analysis is useful with this regard to examine contents of a material (such as reviewed works in this study) and identify themes or patterns. In other words, this qualitative content analysis aimed at identifying MFI success factors in the developing world. This deductive qualitative content analysis also lends itself to the very nature of conventional content analysis method, by being a flexible method for analyzing available materials (Cavanagh, 1997), and the results are presented in narrative way, which is regarded as one of the most established ways of presenting results of a qualitative study (Czarniawska, 1997; Savenye& Robinson, 1996).

Results

A Glimpse of Microfinance

Poverty reduction programs that were initiated by the World Bank in the 1990's by involving governments and institutions from the developing world by giving them loans proved to be highly futile and instead created dependence on aid with little help to the poor (Diop et al., 2007; Javid&Abrar, 2015). More precisely, according to Javid and Abrar (2015), this failure due to disbelief in formal institutions gave the beginning of a shift in development thinking that leads to the emergence of microfinance. The focus is extending support to the informal sector by providing credit to help people to pull them above the poverty line. Hermes et al., (2011) stated that Microfinance Institutions (MFIs) focus on providing credit to the poor who have no access to commercial banks, in order to reduce poverty and to help the poor with setting up their own income generating businesses. Their prime focus is the provision of financial services to low-income people who traditionally have been excluded from financial systems (Pinz, &Helmig, 2015). Millions and millions of people benefitted from microfinance services around the world (Gibbons & Meehan, 2002;Navajas, &Tejerina , 2006). MFIs certainly increased the availability of supply of credit and/or commercial finance to the poor (Aggarwal et al., 2015; Robinson, 2001).

Srneand Svobodová (2009) maintain that microfinance activities in the developing countries have a slightly different nature. These include the prevalence of strong social feeling and active/positive attitude to the expressive 'bottom-up' activity that aimed at supporting the poor at grassroot level; there is widespread poverty in rural areas where all these people housekeep; and the period that the micro financial activities began in these countries started was evidently decided following historical timelines such as decolonization. Speaking of the situation in developed countries, Seibel (2005) noted that in the developed countries microfinance evolved from informal beginnings during the eighteenth and nineteenth centuries as a type of banking of the poor, juxtaposed to the commercial and private banking sector Generally, microfinance literature suggests that in the past few decades MFIsin the developing world achieved notable results. So, the next sections will portray MFI success factors in the developing world by way of systematic review of the existing evidence.

Success Factors

With over 140 million borrowers worldwide the microfinance sector provides access to financial services to low-income households who are not served by traditional banks (Czura et al., 2022).It has been used as a tool for alleviating global poverty for over 40 years and billions of dollars have been loaned and the stories of success are impressive. But, though there have been many important contributions of microfinance institutions, the exact nature of the success factors are less clear, hence as motivated earlier examining the success factors for microfinance institutions is still as important as articulation of the key drivers of success might lead to greater success ofmicrofinance (Epstein& Crane, 2007). Microfinance literature indicates that there are quite a number of success factors in the area of MFIs but these are mostly scattered and isolated studies from different parts of the developing world such as Bangladesh, India, Ghana, Indonesia, Ethiopia, Kenya, South Africa, Morocco, Tunisia and Egypt. Accordingly, the next sections provide the systematic review of the evidence pertaining to the success factors from the developing regions of the world - Africa, Asia, and South America to exhibit the pattern regarding the success factors of microfinance in this part of the world.

MFI Success Factors from some Asian Countries

Asia takes a pivotal place in the development of microfinance. Professor Muhammad Yunus, who was awarded the Nobel Peace Prize in 2006, is from this continent, and he is regarded as the first to establish and successfully develop a micro- financial system in LDCs, to be precise in in Bangladesh –the Grameen Banks (Srnec & Svobodová, 2009). Since then remarkable success has been achieved in the microfinance sector in Asia, especially in the south east region in countries such as in India, Indonesia, and Bangladesh itself. Based on the availability of literature, the next paragraphs highlight evidence on MFI success factors from Bangladesh, India, and Indonesia.

Bangladesh

Accordingly, in investigating the factors that led to the success of microfinance in Bangladesh, Al Mamun (2012) dwell on the case of the famous Grameen Bank and observed that the factors that led to the success include providing training and development program to clients (on loan repayment, and even on nourishment and health matters) ; training and development program for staff as this is instrumental to have effective field workers and field level managers to assist clients in professional ways; motivating employees by providing a well-designed incentive system; adaptation and learning in changing environmental circumstances; and motivating borrowers in mobilizing resources (savings) and allocate resources (loans). In addition, Nasir (2013) posits the success of the Grameen Bank model in Bangladesh and he found out that the success factors included low transaction costs, socially no need for collateral as peer pressure is sufficient, minimum paper work and less formality, repayment of loans are arranged in small amount and short time intervals, and there exists quick loan sanctions.

India

Singh and Padhi (2019) studied factors affecting the performance of MFIs in India and they found out that factors such as assets that the an MFI owns (MFIs having larger assets base are more likely to be successful), the age of the MFI (more older and mature MFIs are more likely to be successful), and borrowers per staff members (the larger the number of borrowers per staff members, the better and the more productive the MFI is). In other words, the authors concluded that availability of assets warrants MFIs have adequate resources to tackle solvency situations and can use it as power/leverage to borrow from the external funders. Similarly, older MFIs are more likely to be successful on the basis of administrative experience and modest financial resources they command at their disposal. Moreover, a successful/productive MFI ensures it reaches to wider borrowers' base.

Indonesia

Hartungi (2007) examined the success factors of MFI in Indonesia, and the author noted that there are crucial factors that have contributed for the success of MFI in the study context. Accordingly, he found out that important MFI success factors included adaptation to changing environmental circumstances to survive and thrive even in difficult circumstances such as in times of financial crisis, being innovative in choosing collaterals (various collaterals have been demanded such as land title, bikes, motorbikes, cars, certain types of cattle, etc) to ensure the sustainability of MFIs and at the same time attracting people to use loan for productive activities, having well-trained and dedicated staffs operating a simple, transparent system; clear incentives to clients and staff (incentive schemes are valuable to recruit and maintain the well-trained staff) and clients, rigorous internal supervision and audit capacities and financial procedures and sound financial risk management.

MFI Success Factors from some African Countries

As indicated in the preceding sections, microfinance has become an essential tool in the developing regions of the world and coupled with the widespread confidence that it helps ease poverty, the sector has attracted several donors and stakeholders, and as a result, microfinance is practiced widely across the world and has a strong presence in Africa (Armendáriz&Morduch, 2007; Churchill, 2018). Besides, according to Van Rooyen, Stewart, and De Wet(2012), microfinance is seen as a key development tool that keeps growing in Africa. There are several reasons that explain the growth and/or success of the sector in the African continent.Based on the availability of literature, the next paragraphs demonstrate some evidence on MFI success factors from Ethiopia, Ghana ,Kenya, Namibia, South Africa, and North Africa (Morocco, Egypt, and Tunisia).

Ethiopia

Amha and Narayana (2000) in their analysis of the performance of MFIs in Ethiopia, they indicated that there is an encouraging success of microfinance activities in Ethiopia in a short period of time, and they linked the success to the following factors - MFIs in Ethiopia have a shared vision of poverty alleviation; availability of favorable macro policy environment and regulatory frameworks to promote sustainable microfinance activities; achievement of good repayment rates by MFIs; emphasis on financial sustainability (and to realize this MFIs are concentrated on accessible regions); mobilization of significant amount of savings by MFIs ; and a growing demand for input credit for to farmers to purchase fertilizer and improved seeds

Besides, Gobezie (2008) studied successes in the expansion of microfinance in Ethiopia especially in the rural Ethiopia, and he observed that microfinance has expanded well in the country even to rural villages and he found out that the success factors are innovative adaptation of the group guarantee lending approach by effectively customizing it to the local realities; decentralization of operations by the MFIs, and utilizing indigenous knowledge and resources in client screening and follow-up. The author explained that the groups guarantee lending method is widely used in which potential borrowers are required to exercise a peer group self-selection and organize groups for the purpose of sharing a mutual loan repayment guarantee. Concerning the decentralization of operations, the author noted that frequent monitoring and follow up of each borrower is undertaken in most cases to ensure full repayment (with very low loan sizes) and very small savings as low as $1 or even smaller than this are also encouraged to mobilize resources.

Further, Kinde (2012) also examined the sustainability of MFIs in Ethiopia, and he observed that the breadth of outreach (number of borrowers) and depth of outreach (the average loan size) are important success factors for MFIs in Ethiopia.

Ghana

Boateng and Agyei (2013) examined twelve MFIs in Ghana in their endeavor to assess the development, success and challenges of the MFIs in the study context, and they identified the success factors for MFIs as provision of services which are suitable and consistent with customers' situation and needs, character- based lending, frequent visit of credit officers to customers. In other words, the authors maintained that extending services to clients/borrowers according to their needs and situations was a strategic move by the MFIs as this accounts for the demands of the customer base that the MFIs depend to thrive. With regards to the character based lending factor, the MFIs assess the character of their clients and their credit worthiness, and according to these elements the MFIs may apply different rates of interest; it is indicated that it may take some time to learn about the character of the clients as this is usually assessed through successive transactions engaged with the clients and the loan repayment patterns by them. Moreover, the frequent visit of credit officers to clients' place of business serves a purpose of monitoring progress and reminding clients of loan repayments.

Kenya

Macharia (2011) surveyed the success factors of MFIs in Kenya and the study found out that product-delivery innovations and creation of value networks were the most effective success factors for MFIs that influence their success by way of enabling the MFIs to achieve better financial performance, improve financial deliver, and improve shareholders value and the MFIs themselves. Besides, Mwanzia (2013) examined the success factors and competitive advantages of MFIs in Kenya and the study found out additional, important success factors - strong customer service culture and group based lending approach, which are critical in enhancing the competitive advantage of MFIs.

Namibia

Mulunga (2010) studied the factors affecting the growth of MFIs in Namibia and the author noted that the (skilled) staff, mentorship and assistance by loan officers, and monitoring and follow ups play critical roles in the success of MFIs. In other words, the author reiterated that skilled staffs are essential to the success of MFIs because they are responsible to make sure that clients fully understand the terms and conditions of the loan as well as the financial products provided to them. Besides, the loan officers should be able to offer the necessary mentorship and other assistance required by clients to equip them with the necessary basic skills regarding managing the clients business activities. More so, monitoring and follow-ups on loan repayments are essential in ensuring that loan conditions are adhered to.

South Africa

Kiweu (2009) in his study of the critical success factors of microfinance, he indicated that the liberalized financial sector; stable macro-economic environment; supportive banking reforms; and size of microfinance institution have favorable outcomes for the success of MFIs in South Africa. Besides, Skowronski (2010), who studied the MFI sector in South Africa stated that age of an MFI is an important success factor as successful MFIs in the country required years to reach sustainability. (Southern Africa, south Africa)

North Africa

Compared with the development of MFI in other parts of Africa, in North Africa, there is a glaring absence of micro-insurance (UN, 2013). However, study conducted by Allaire et al (2009)to explain the success of Morocaan, Tunisian and Egyptian MFIs. Accordingly, their study asserts that that while availability of oil exports as revenues source is delaying the development of MFIs in the region, success of MFIs in Morocoo are linked to age of the MFIs (maturity and experience as they get older), population density (MFIs in densely populated urban areas are more developed), its poverty (microfinance is more developed in less industrialized economies/ microfinance is more present in poorer countries countries)) and low literacy rates as well as the amount of international donor funds it has received. The authors have also indicated that location seems to be a key success factor in Egypt and Tunisia, where the largest MFIs are located in the countries capital cities and large towns such Tunis, Cairo and Giza (at the base of the great pyramids where there are many artisans and small business activities) and location stands out as a success factor because North African MFIs target urban people rather than rural people who are really dispersed. Further, the authors noted that MFI is either a very recent phenomenon in other parts of the country (e.g Algeria) or there is lack of data/information about MFIs in the region (e.g Libya).

MFI Success Factors in South America

According to Dacheva (2009) the microfinance sector in south America is considered to be heavily dominated by Non-governmental organizations (NGOs), which are lately starting to look more like commercial institutions. Taking into account the great profitability of the sector, it seems that this transformation process has been very successful and has impacted the region in a very positive way. And as such, the author indicated that the success of microfinance in Latin America is attributed to the commercialization phenomenon.

By and large, in addition to region focused findings above, other scholars have also noted general success factors in MFIs. For example, Ahlin and Lin (2006) observed that the macro economy is an important determinant of MFI performance, though not more so than institution-specific factors. The authors reiterated that MFIs success, at least in terms of financial sustainability, growth, and repayment rates, is significantly affected by the macroeconomic environment in which they are situated and they discovered that generally, high growth is good for MFI performance. However, the authors have also indicated that there appear to be some signs of rivalry between microfinance and industrial-led growth, proxied by share of GDP in manufacturing and by FDI as the more industrially advanced the country; the more difficult for MFI's to grow and recover loans. In addition, they maintained that their argument is not that MFIs should seek to locate in high-growth economies because this puts aside the social impact that MFI's can have in situations where the macro economy leaves petite hope.

Gutiérrez-Nieto and Serrano-Cinca, (2010) and Morduch (1999), on the other hand, observed that the third element, called funders (apart from the MFI itself and the clients,) play critical role in the success of MFIS. The authors argue that a peculiar feature of MFIs is that many receive external donations and subsidies from funders although there exists and growing competition to attract MFI funding. Ironically, this competition for funding itself led to another success factor - MFIs working hard to build trust among their funders and ensure availability of microcredit to the poor. The authors underlined that even the success of Grameen Bank is largely based on the subsidies received from funders and they insist that the roles played by funders to make MFIs successful should be recognized.

Discssion and Conclusions

This study attempted to exhibit some evidence regarding success factors of MFIs by employing success factor research approach, which is becoming a popular research approach in organizational studies. The focus of success factor research is bringing to the fore the idea of why some organizations perform better than others, i.e; success factors and the lessons learnt from these successes are considered essential to further enhance organizational success in other entities and contexts (Grunert, & Hildebrandt,2004). In light of this guiding idea, this study reviewed some evidence of MFIs success factors from Asia, Africa, and South America, which are largely regarded as developing parts of the world (UNDP, 2021/22). Certain evidence of success factors of MFIs was demonstrated from Bangladesh, India, Indonesia, Ethiopia, Ghana, Kenya, Namibia, South Africa, and North Africa (Morocco, Egypt, and Tunisia); and from South America (in general).

In Bangladesh, some of the success factors for MFIs include providing training and development program to clients; training and development program for staff; and motivating employees by providinga well-designed incentive system. In India, the success factors for MFIs are the amount of assets that the an MFI owns; the age (maturity) of the MFI and number borrowers per staff members (the larger the better). In Indonesia, adaptation to changing environmental circumstances to survive and thrive even in difficult circumstances such as in times of financial crisis; being innovative in choosing collaterals; training levels of the staffs; clear incentives to clients and staffs are found to be the success factors for MFIs.

In Ethiopia, factors that are considered as contributing to the success of MFIs are found to be shared vision that MFIs have to utilize microfinance as poverty alleviation tool; conducive regulatory framework that promotes microfinance; good repayment rates by MFIs; emphasis on financial sustainability; creative use of group guarantee lending approach by tailoring it to local realities; and utilizing indigenous knowledge and resources in client screening and follow-up. In Ghana, the study noted that some of the success factors for MFIs are the ability of the MFIs to offer microfinance products that meet the needs and situations of clients; character- based lending after assessing and learning about the character of each client; and regular visitations by loan officers to clients. In Kenya, the success of MFIs is attributed to product-delivery innovations; strong customer service culture; and group based lending approach. In Namibia, the success factors of MFIs are due to skilled employees of the MFIs, who are responsible to interact and convince, and support borrowers; mentorship and further assistance extended to borrowers by loan officers; and monitoring and follow-up activities on loan repayments. In South Africa, some of the factors that facilitated the success of MFIs are the liberalized financial sector; steady macro-economic environment; helpful banking reforms; and size and age of MFIs.

Besides, in North Africa (Tunisia, Egypt, and Morcco) the success of MFIs are ascribed to donor funds and locations that MFIs operate - MFIs operating in in densely populated urban areas are more successful. And in South America, in general, commercialization phenomenon is lately considered as a success factor for the development of MFIs.

In conclusion, the results of the study indicate that that, indeed, MFI success factors vary across MFIs and their respective regions. This implies that the success factors of MFIs vary from context to context and it is difficult to come up with a single profile of success factors for MFIs. Even in this study alone, it is found out that the success factors tend to vary and range from being innovative in choosing collaterals involving land title, bikes, motorbikes, cars, and cattle to ensure the sustainability of MFIs (Asia) to utilizing indigenous knowledge and resources in client screening and follow-up (Africa) and commercialization phenomenon (South America).

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