Challenges Affecting Transformation of Microfinance Institutions into Deposit Taking Financial Institutions in Kenya

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2015

DECLARATION

This thesis is my original work and has not been presented for a degree in any other University.

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This thesis has been submitted for examination with our approval as University Supervisors.

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DEDICATION

This work is dedicated to my family and parents: wife Kanana Koome; children Rimiri, Muriungi, Nkirote, Karimi and Muguna; and parents M'Rukaria M'Meru, Charity M'Rukaria, Kiriinya Magiri and Wanja Kiriinya.

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ABBREVIATIONS AND ACRONYMS

AGM	Annual General Meeting
AMFI	Association of Microfinance Institutions in Kenya
ASCAs	Accumulated Savings and Credit Associations
BOD	Board of Directors
BPS	Board of Post Graduate Studies
CBK	Central Bank of Kenya
CBO	Community Based Organization
CGAP	Consultative Group to Assist the Poorest
Co	Company
DTM	Deposit-Taking Microfinance
ICT	Information and Communications Technology
K-Rep	Kenya Rural Enterprise Programme
KWFT	Kenya Women Finance Trust
Ltd	Limited
MFI	Microfinance Institution
MSEs	Micro and Small Enterprises
NGO	Non-governmental Organization
PCA	Principal Component Analysis
POS	Point of Sale
RFI	Regulated Financial Institution
ROSCAs	Rotating Savings and Credit Associations
SACCOs	Savings and Credit Cooperative Society
SPSS	Statistical Package for Social Sciences

DEFINITION OF TERMS

Deposit is the sum of money received or paid on terms under which it shall be repaid, with or without interest or a premium (Republic of Kenya, 2006). It is received or paid either on demand or at a time or in circumstances agreed by or on behalf of the person making the payment and the person receiving it.

Deposit-taking microfinance means a microfinance business in which the person conducting the business holds himself out as accepting deposits on a day-to-day basis (Republic of Kenya, 2006). It includes any other activity of the business which is financed wholly or to a material extent, by lending or extending credit for the account and risk of the person accepting the deposit, including the provision of short-term loans to small or micro enterprises or low income households and characterized by the use of collateral substitutes.

Institutional change management is the process of managing the changes that occur to an MFI as a result of transformation (Ivatury, Pickens, & Siedek, 2006).

Legal compliance is the process of meeting all the legal requirements for the purpose of getting licensed as a deposit taking microfinance institution (Republic of Kenya, 2006).

Microfinance is the provision of financial services like credit, savings, insurance, leasing, and remittances (referred to as financial intermediation) to low-income clients, including the self-employed (Hishigsuren, 2006). According to Ledgerwood (1999), some microfinance institutions (MFIs) provide social intermediation services

in addition to financial intermediation. Social intermediation includes services like helping clients to form groups, develop self-confidence, and acquire financial literacy.

Microfinance business is, according to the Kenyan statutory law on microfinance, the business of receiving money, by way of deposits or interest on deposits, which is lent to others or used to finance the business; or providing loans or other facilities to micro or small enterprises and low income households (Republic of Kenya, 2006). This is the meaning adopted by this study.

Microfinance institution refers to an institution which provides microfinance, but is currently not regulated under the Banking Act (Republic of Kenya, 2006).

Management of Stakeholders is the process and actions taken to manage various entities that have a stake in an MFI (Miles, 2012) to ensure successful transformation. These entities include employees, customers, investors, suppliers, and communities (Gichira, 2005; Richman, 2008; Mulwa, 2008; Gitonga, 2010).

Planning for transformation refers to the preparations that a transforming MFI puts in place beforehand to ensure that it will succeed in the transformation (Ledgerwood & White, 2006). It includes securing an agreement from the board and key managers on the need to transform, assessing the readiness to transform, appointing a transformation manager, preparing a transformation plan, and making initial consultations with the regulator.

Transformation is the establishment of a regulated financial institution (RFI) by an NGO or a group of NGOs, or any other MFI, by transferring part or the whole of its loan portfolio to the RFI (Fernando, 2004). It is, therefore, the process by which an MFI converts into a "formalized" or regulated financial institution (RFI). Henceforth, the MFI is regulated and supervised by the country's financial regulatory authority, which is usually a central bank.

Transformation process is the process of converting a non-regulated MFI undertaking microfinance business to a regulated and supervised financial institution (Hishigsuren, 2006). In this study it specifically refers to the process through which an MFI becomes a deposit taking microfinance institution (DTM) under the microfinance Act of 2006. It covers the period from when the decision to transform is taken to the time when the MFI is issued with a license by the central bank.

ABSTRACT

With the enactment of the Microfinance Act of 2006 and issuance of the regulations to enforce it, MFIs in Kenya were for the first time provided with a legal framework within which to transform specifically into deposit taking microfinance institutions (DTMs). Previously, the only available option in Kenya was for them to transform into commercial banks. Evidence from countries like Bolivia and Peru indicate that the transformation process is not easy as MFIs face a variety of challenges not only when planning for but also during transformation process. However, this available information is not conclusive on the relative significance of each of those challenges in transformation of MFIs. Besides, the main model previously tried in Kenya and other countries involved transformation of MFIs into commercial banks. This study, therefore, sought to determine the specific challenges affecting transformation of MFIs into deposit taking financial institutions in Kenya. The objectives of the study were to determine how planning, legal compliance, management of stakeholders, and institutional change management affect the transformation of MFIs into DTMs in Kenya.

This study used the cross-sectional survey research design. The target population of the study was 48 MFIs that were members of the Association of Microfinance Institutions in Kenya (AMFI) as at 1st January 2013. The study purposively sampled 25 MFIs from which 100 respondents were randomly selected. A questionnaire was used to collect data. Data entry, storage and analysis were done with the aid of Scientific Package for Social Sciences (SPSS). The data was first explored for the underlying factor structure among the study variables through factor analysis. Thereafter, the study undertook both descriptive and inferential statistical analyses. In particular, the study used the mode, Pearson Chi-square and Direct Logistic Regression to analyse the data.

The study established and concluded that planning was not a significant challenge affecting the transformation of microfinance institutions into deposit taking institutions in Kenya. The study also concluded that legal compliance and institutional change management were significant challenges affecting the transformation of microfinance institutions into deposit taking institutions in Kenya. This study further concluded that management of stakeholders was not a significant challenge affecting the transformation of microfinance institutions into deposit taking institutions in Kenya.

The study recommended that MFIs wishing to transform in Kenya should allow themselves adequate time so as to understand fully the environment and the legal and regulatory framework. This entails committing a lot of time and resources to planning and initial preparations. Transforming MFIs also need to understand the complete licensing process in order to be prepared well. The study recommended further research to determine the impact of Microfinance regulation in Kenya, compare the experience of newly created DTMs and those that have transformed with the process of registration and licensing. This study recommended a review the policy and law to allow for phased transformation. The policy and law should also be reviewed to allow the transformed MFIs a tax holiday and exempt from tax any assets donated or transferred to the DTM by the mother NGO MFI.

CHAPTER ONE

INTRODUCTION

1.1 Background to the Study

The existence of a strong correlation between access to financial services and economic development is widely acknowledged (Christen, Rosenberg, & Jayadeva, 2004). This is because increasing access to financial services results in employment generation, economic growth, and contributes to human development. Despite this, it is estimated that about three billion working-age people in the world still lack access to a broad range of financial products and services on a sustainable basis (Christen *et al*., 2004).

There are broadly two sources of financial services. One of the sources is the formal banking sector while the other one is the informal sector. The formal banking sector serves less than 20% of the population in developing countries (Robinson, 2001). The rest of the population, typically low-income households, has historically not had access to formal financial services (Chiumya, 2006). According to a recent study on financial access (called FinAccess) in Kenya, 19% of the Kenyan adult population uses financial services from the formal financial institutions which are regulated by the monetary authority like banks and building societies and post office savings bank (Arora & Ferrand, 2007). Alternative formal financial institutions which are not regulated by the central bank, like Savings and Credit Cooperatives (SACCOs) and MFIs, reach 8% of the adult population. This means that only 27% of the adult population access financial services from banks and other formal regulated non-bank financial institutions. Another 35% of the adult population uses financial services

from informal sources like Rotating Savings and Credit Associations (ROSCAs) and Accumulated Savings and Credit Associations (ASCAs). The other 38% of adult Kenyans do not use financial services from any source.

Overall, those who access financial services from informal sources and those who are not served by any source total to 73% of the adult population. These are excluded from the formal sources and are said to be "unbanked". According to Arora and Ferrand (2007), this implies that Kenya faces a great challenge in her efforts at developing an inclusive financial system. They further observe that those levels of access compare favourably to Kenya's regional neighbours, yet, in the context of the Vision 2030, Kenya seeks to benchmark its economic performance either with rapidly growing countries (such as Vietnam) or middle-income countries (like South Africa, Namibia or Thailand) which have considerably higher levels of access. They conclude that Kenya would have to raise the formal access to 50% in order to achieve those benchmarks by 2030.

In Kenya, the limited access to financial services has over the years been cited as one of the major constraints inhibiting the growth of the Micro and Small Enterprises (MSEs) sector (Central Bureau of Statistics, International Centre for Economic Growth, & K-Rep Holdings, 1999; Republic of Kenya, 2005). Yet, the MSE sector makes a significant contribution to the economic development of the country, amounting to up to 18.4% of the country's Gross Domestic Product (Republic of Kenya, 1992; 2005; Gichira, 2005). The problem of limited access to credit has further been shown to be more as a result of supply-side constraints (Atieno, 2001).

It is in a bid to address the problem of access to financial services that Microfinance Institutions (MFIs) emerged. Microfinance institutions are organizations that provide financial services to the poor (Atieno, 2001). Since the 1970s, MFIs have been testing and developing a practical approach to serve those historically excluded from accessing financial services from the formal banking sector.

Over the years and as the need to build inclusive financial sectors became apparent, microfinance came to be accepted as a poverty alleviation tool. In addition, many countries started exerting efforts to ensure that financial services for the economically active poor are implemented on a large scale by multiple and competing financially self-sufficient institutions (Robinson, 2001). Consequently, the pressures for growth led to the need for regulation and supervision of microfinance institutions. Regulation and supervision is seen as a way of ensuring the provision of financial services to the poor by financially sustainable institutions on a massive scale, promoting microfinance and improving performance, protecting depositors where MFIs accept deposits, and ensuring financial system stability where MFIs have grown to such extent that the failure of one may disrupt the financial sector (Chiumya, 2006).

One popular view has been that major increases in microfinance outreach needs to come from banks (Vogel, Gomez, Fitzgerald & IMCC, 1999). This is based on the comparison of size of the typical bank and the typical microfinance institution and the fact that most of the largest microlenders are banks like Grameen, BRI, and Bancosol.

Just like has happened globally, Kenya has experienced a rapid growth of the microfinance sector since the 1980s. However, the MFIs operated without a proper

legal and regulatory framework (Atieno, 2001; Republic of Kenya, 2005), which greatly hampered their capacity to grow (KIPPRA, 2001). For instance, they could not mobilize public deposits for on-lending, yet their sources of funds continued to dwindle while the demand for credit and other financial services continued increasing. Besides, MFIs continued to face pressure from their donors to become self-sustaining. This led to the need to commercialize microfinance. Commercialization of microfinance refers to the application of market-based principles and the movement out of the heavily donor-dependent arena of subsidized operations into one in which microfinance institutions manage on a business basis (Christen & Drake, 2002). One of the ways that an MFI can commercialize is transformation. Transformation is the institutional process whereby an NGO microfinance provider or a microfinance project creates or converts into a share-capital company and becomes licensed as a regulated financial institution (Ledgerwood & White, 2006). After transformation, the institution is lawfully allowed to mobilize deposits from the public and use the same funds for on-lending rather than relying on funds from donors.

The first case of transformation in Kenya was the Kenya Rural Enterprise Programme (K-Rep), which occurred in the absence of a legal framework for the regulation and supervision of MFIs. A commercial bank, K-Rep Bank, was created following the transformation of the Kenya Rural Enterprise Programme (K-Rep) from NGO to a diversified holding company (Rosenngard, Rai, Dondo & Oketch, 2000). Although the experience of K-Rep offers some insight into the challenges that an MFI may face in the process of transforming into a commercial bank, this was the first time that MFIs in Kenya have to transform into regulated deposit-taking microfinance institutions within a regulatory framework outside the commercial banking form.

The enactment of the Microfinance Act in 2006 (Republic of Kenya, 2006) provided the environment for the second round of transformations. From 2006, MFIs that wished to do so started seeking to transform with a regulatory framework specific for MFIs in place. This statute provided for the regulation and supervision of deposit-taking microfinance institutions (DTMs) in Kenya. Its enactment provided MFIs that were interested with a second option of transforming to become regulated deposit-taking institutions. This was in addition to the first option that had already been tried by K-Rep earlier on, that is, converting into a commercial bank. This was expected to spur rapid growth in the microfinance sector as those that transformed successfully would be licensed and allowed, lawfully, to mobilize deposits from the public and use the same funds for on-lending.

According to a recent study on financial access (called FinAccess) in Kenya, 19% of the Kenyan adult population uses financial services from the formal financial institutions which are regulated by the monetary authority like banks and building societies and post office savings bank (Arora & Ferrand, 2007). Alternative formal financial institutions which are not regulated by the central bank, like Savings and Credit Cooperatives (SACCOs) and MFIs, reach 8% of the adult population. This means that only 27% of the adult population access financial services from banks and other formal regulated non-bank financial institutions. Another 35% of the adult population uses financial services from informal sources like Rotating Savings and Credit Associations (ROSCAs) and Accumulated Savings and Credit Associations (ASCAs). The other 38% of adult Kenyans do not use financial services from any source.

Overall, those who access financial services from informal sources and those who are not served by any source total to 73% of the adult population. These are excluded from the formal sources and are said to be "unbanked". According to Arora and Ferrand (2007), this implies that Kenya faces a great challenge in her efforts at developing an inclusive financial system. They further observe that those levels of access compare favourably to Kenya's regional neighbours, yet, in the context of the Vision 2030, Kenya seeks to benchmark its economic performance either with rapidly growing countries (such as Vietnam) or middle-income countries (like South Africa, Namibia or Thailand) which have considerably higher levels of access. They conclude that Kenya would have to raise the formal access to 50% in order to achieve those benchmarks by 2030.

In addressing the problem of access to finance by reaching large numbers of people, the global trend is to move microfinance into institutions that are licensed and supervised by a country's financial authorities (Hishigsuren, 2006). For instance, by March 2006, about 43 non-governmental organization (NGO) MFIs were transformed (Hishigsuren, 2006) worldwide. Most of the cases occurred in Latin America, particularly in Peru. For example, in Latin America, 24 MFIs in 8 countries transformed. In Asia, 12 MFIs in 6 countries and, in Africa, 7 MFIs in 4 countries transformed. One of the models being used to achieve that significant outreach is the transformation of microfinance organizations into regulated deposit-taking microfinance institutions (DTMs).

1.2 Statement of the Problem

Worldwide, transforming MFIs into deposit taking financial institutions has become more and more appealing to an increasing number of MFIs. This is due to the anticipated benefits to the MFIs, their clients and other stakeholders. The anticipated benefits include the ability of the transformed MFIs to mobilize public deposits, access private sources of capital, and improve their governance and transparency, reaching significant scale and financial sustainability, and ultimately being able to help in improving the level of financial inclusion in the country (Hishigsuren, 2006). In Kenya, prior to the enactment of the Microfinance Act in 2006, the microfinance sector had for a long time lobbied for the development of a specific legal and regulatory framework to guide and support the transformation of microfinance institutions into deposit taking financial institutions (Atieno, 2001; Republic of Kenya, 2005, Ledgerwood & White, 2006; Mutahi, 2008).

Although MFIs in Kenya always had the option of transforming into commercial banks, it was argued that the commercial banking law was too stringent, not responsive to the special needs of the microfinance sector, and was largely prohibitive as it had been shown earlier on by the experience of K-Rep. Therefore, it was felt that it was necessary to develop a specific legal and regulatory framework for the sector. After the Microfinance Act was enacted, Microfinance Institutions in Kenya started seeking to transform into DTMs (Republic of Kenya, 2008). However, by the end of 2010, only 3 MFIs had successfully completed the process of transformation and had been granted a license by the Central Bank.

The small number of successful MFI transformations in Kenya from 2006 to 2010 was attributed to diverse challenges faced during the transformation process (Frankfurt School of Finance & Management, 2012). The experience from other countries like Bolivia, Cambodia, India, Mongolia, Nepal, Pakistan, Philippines, Uganda, and Peru indicates that the transformation process was not easy. This is because transforming microfinance institutions in those countries faced financial, management, infrastructural, legal and other challenges (Campion & White, 1999; Hishigsuren, 2006). The numerous challenges in the transformation process can be grouped into four categories, namely, planning, legal compliance, management of stakeholders, and institutional change management. However, the available information was not conclusive on the specific challenges faced by transforming MFIs in Kenya. Yet, it is important to understand and address the challenges to MFI transformation in Kenya to make it possible for the majority of MFIs to transform faster, so that the anticipated benefits can be achieved earlier. This study, therefore, sought to determine the specific challenges affecting the transformation of microfinance institutions into deposit taking financial institutions in Kenya.

1.3 Objectives of the Study

1.3.1 General Objective

This study sought to determine the challenges that affect the transformation of microfinance institutions into deposit taking financial institutions in Kenya.

1.3.2 Specific Objectives

The study addressed the following specific objectives:

1. To establish the effect of planning on the transformation of microfinance institutions into deposit taking financial institutions in Kenya.
2. To determine the effect of legal compliance on the transformation of microfinance institutions into deposit taking financial institutions in Kenya.
3. To evaluate the effect of management of stakeholders on the transformation of microfinance institutions into deposit taking financial institutions in Kenya.
4. To examine the effect of institutional change management on the transformation of microfinance institutions into deposit taking financial institutions in Kenya.

1.4 Research Questions

The study sought to answer the following research questions:

1. What is the effect of planning on the transformation of microfinance institutions into deposit taking financial institutions in Kenya?
2. What is the effect of legal compliance on the transformation of microfinance institutions into deposit taking financial institutions in Kenya?
3. What is effect of management of stakeholders on the transformation of microfinance institutions into deposit taking financial institutions in Kenya?
4. What is the effect of institutional change management on the transformation of microfinance institutions into deposit taking financial institutions in Kenya?

1.5 Hypotheses

The study was guided by four null hypotheses and four alternative hypotheses respectively. The null hypotheses and their respective alternative hypotheses are as follows:

Hypothesis 1

H_{01} There is no significant effect of planning on the transformation of microfinance institutions into deposit taking financial institutions in Kenya.

H_{a1} There is a significant effect of planning on the transformation of microfinance institutions into deposit taking financial institutions in Kenya.

Hypothesis 2

H_{02} There is no significant effect of legal compliance on the transformation of microfinance institutions into deposit taking financial institutions in Kenya.

H_{a2} There is a significant effect of legal compliance on the transformation of microfinance institutions into deposit taking financial institutions in Kenya.

Hypothesis 3

H_{03} There is no significant effect of management of stakeholders on the transformation of microfinance institutions into deposit taking financial institutions in Kenya.

H_{a3} There is a significant effect of management of stakeholders on the transformation of microfinance institutions into deposit taking financial institutions in Kenya.

Hypothesis 4

H_{04} There is no significant effect of institutional change management on the transformation of microfinance institutions into deposit taking financial institutions in Kenya.

H_{a4} There is a significant effect of institutional change management on the transformation of microfinance institutions into deposit taking financial institutions in Kenya.

1.6 Significance of the Study

This study is significant in a number of ways. The findings of the study are of great benefit to the microfinance sector in Kenya. This is because the findings are a valuable source of information for any microfinance institution that might wish to transform in future. Armed with the information on the challenges that they are likely to face as well as the tested methods of dealing with them, such MFIs will be able to manage the process with more ease.

The findings are also useful to policy makers in the area of regulation and supervision of deposit-taking microfinance institutions. The study provides useful knowledge on how various legal, regulatory and procedural requirements could impact on the MFIs as they endeavour to transform. In this way, the study findings offer useful inputs to advise the review of the policy and legal framework in the future.

In addition, the study is important as the findings have contributed to the existing body of knowledge on microfinance transformation. This is important not only in Kenya but also globally for posterity of the sector, its clients and humanity in general.

The study further offers useful insights to scholars and sector practitioners through its recommendations on areas requiring further research. This is critical for the testing and improvement of the emerging model of MFI transformation into deposit taking financial institutions. Over time, this will assist in the development of a theory of microfinance transformation.

This study is also important because of the need to improve the level of access to financial services by low income people and MSEs in Kenya. This is because only a small percentage of MSEs have access to financial services. For instance, the national baseline survey on MSEs in Kenya carried out in 1999 established that 89.6% of MSEs had not received credit from any source (Central Bureau of Statistics *et al*, 1999). This means that only 10.4% of MSEs had received credit from both formal and informal sources. Of these, 5.7% had received credit from formal credit institutions, including NGOs, and 4.7% from informal sources. According to the survey results, of the formal sources of credit, NGOs were the most important. The above situation had not changed much by the time of this study as evidenced by FinAccess, a recent study on access to financial services in Kenya (Arora & Ferrand, 2007; Financial Journal, 12th August 2008). According to this study, 19% of Kenyans access credit from banks, 8% from SACCOs, and 35% from informal sources. The rest of Kenyans (38%) are still un-served, a situation that the enactment of the Microfinance Act 2006 sought to address by providing the framework to regulate and supervise deposit taking MFIs. Yet, it is generally recognized that a significant scale of outreach is an ultimate goal for microfinance operations (CGAP, 2004). To reach large numbers of people, microfinance must eventually move into institutions that are licensed and supervised by a country's financial authorities. Transformation of microfinance organizations

into regulated deposit-taking MFIs is one of the important models used to achieve that significant outreach (Hishigsuren, 2006). It was, therefore, necessary that the MFIs be provided with empirical information on various aspects of the transformation process.

1.7 Scope of the Study

This study on the challenges that affect the transformation of microfinance institutions into deposit taking financial institutions in Kenya was conducted through a cross-sectional sample survey design. The study was conducted in 25 microfinance institutions that had head offices in Nairobi, selected from the 48 registered MFIs that were members of AMFI as at 1st January 2013. Data was collected by the researcher from 60 respondents from 18 of the 25 sampled MFIs using a questionnaire. The study specifically sought to establish whether planning, legal compliance, management of stakeholders and institutional change management were challenges affecting the transformation of microfinance institutions into deposit taking financial institutions in Kenya. The study focused only on the challenges faced during the transformation process, that is, from the time that an MFI makes a decision to transform to the time that it is issued with a license by CBK.

1.8 Limitations of the Study

The limitation of this study is that in some instances, it became impossible to be present when some of the respondents like members of board of directors were filling in the questionnaires, even when an appointment had been secured in advance. Ideally, the researcher should have been present when each respondent filled in the questionnaire so as to clarify to the respondent any matter arising and also to seek

clarifications from the respondent on data provided. However, this proved difficult with board members and managers. This is because board members were found in the office only periodically while some of the managers were involved in a lot of travelling for duty outside the office. To remove the possibility of this lowering the validity and reliability of the study, the researcher called such a respondent and explained in depth the nature of the study and the data required before leaving a copy of the questionnaire in the office for him or her. The researcher also agreed with the respondent when he would come back to pick the completed questionnaire. Upon collecting the questionnaire, the researcher would call the respondent for clarification in case he noticed that some data was vague or had not been provided at all.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This study was informed by a comprehensive review of the relevant theoretical and empirical literature. This helped in building an in-depth understanding of the current body of knowledge on microfinance transformation dynamics. Furthermore, a review of the findings and recommendations of related studies helped in putting this study into context. From a synthesis of the literature review, a conceptual framework on transformation challenges was developed. The conceptual framework identifies the dependent and independent variables and was used to guide this study.

This chapter, therefore, presents a review of the literature relevant to this study. It is organized in the following main sections: Introduction; Theoretical framework; Conceptual framework; Planning for transformation as a challenge; Legal compliance as a challenge; Management of stakeholders as a challenge; Institutional change management as a challenge; transformation status; critique of the existing literature and research gaps, and a summary.

2.2 Theoretical Framework

A theory is an argument of ideas intended to explain a phenomenon (Oso & Onen, 2009). It explains a phenomenon by specifying variables and the laws that relate the variables to each other. It is the examination of the existing or self-formulated theories in relation to the research objectives. At the start of a study, the researcher usually presumes that the independent variables have some influence on the dependent

variable. It is this assumption that a researcher tries to justify in the theoretical framework by explaining how and why the independent variable(s) influences the dependent variable. By reviewing the relevant theories, a researcher acquires clarity and better understanding of the theoretical foundation of the study (Kombo & Tromp, 2006). In addition, a review of the relevant theories gives the researcher an insight into what has already been done in the selected field, and thereby enabling the identification of additional information required to avoid duplication in research.

The development of entrepreneurship derives its theoretical foundations from many disciplines like economics, psychology and sociology. Cognisant of this, Kibas (1995) asserts that the study of entrepreneurship requires a multi-disciplinary approach. Consequently, this study was guided by classical theories of entrepreneurship as well as relevant theories relating to MFI transformation. The classical theories of entrepreneurship were economic, psychological and sociological theories while the theories relating to MFI transformation were capital theory, human capital theory, stakeholder theory and agency theory.

2.2.1 Economic Theory of Entrepreneurship

The economic theory of entrepreneurship is one of the theories that guided this study. The economic theory of entrepreneurship holds that entrepreneurial behaviour is influenced by economic factors (Bwisa, 2011; Nteere, 2012). The theory sees an entrepreneur as the person who brings together the factors of production, that is, land, capital and labour, into a combination that makes their value better than before.

According to Swedberg (2007), an entrepreneur introduces new combinations in the form of new products, new production methods, new markets, and new sources of materials and other supplies. This ends up creating disequilibrium in the economy. Thus, an entrepreneur is both an innovator and a risk bearer. Through innovation and creativity, an entrepreneur enhances competition and this ultimately leads to an improvement of the performance of the business.

The economic theory was considered relevant to this study on transformation of MFIs in Kenya. This is because the overall aim of transforming MFIs is to improve their performance so as to make them self-sustaining (Christen & Rosenberg, 2003; Mutahi, 2008; Frankfurt School of Finance & Management, 2012). Transformation in itself is a creative and innovative process which ultimately enables a deposit taking MFI to access new sources of capital, introduce new products, and reach out to new markets. In addition, the provision of microfinance services by deposit taking financial institutions that have transformed from non-deposit taking MFIs is a fairly new model of providing microfinance services in Kenya. It, therefore, entails taking risks since there is no certainty that any MFI that starts the transformation process will be successful.

2.2.2 Psychological Theory of Entrepreneurship

This study was also guided by the psychological theory of entrepreneurship. This theory of entrepreneurship holds that entrepreneurs are differentiated from non-entrepreneurs by character and personality traits (Hisrich, Peters, & Shepherd, 2007; Khanka, 2007; Singal, 2009; Bwisa, 2011; Nteere, 2012). Proponents of the psychological theory further state that entrepreneurs carry out their activities

differently by acting and reacting in a different way. According to Dollinger (1994), this difference is part of the intrinsic mental programming of entrepreneurs.

According to the theory, entrepreneurs are driven by traits like a high need for achievement, a high propensity to take risks and an internal locus of control (Singal, 2009; Bwisa, 2011; Nteere, 2012). Other traits are persistence, desire for immediate feedback, self-confidence, a high desire for independence, flexibility, and future-orientation.

Although the psychological theory is largely based on individual traits, the same can be extended to institutions like MFIs. In this case, entrepreneurial institutions are those that are guided in their decision making and actions by the entrepreneurial traits high need for achievement, a high propensity to take risks and an internal locus of control. This is more so for MFIs transforming into deposit taking financial institutions. The institutions are also driven by the traits of persistence, desire for immediate feedback, self-confidence, a high desire for independence, flexibility, and future-orientation.

2.2.3 Sociological Theory of Entrepreneurship

The sociological theory of entrepreneurship is another theory that guided this study. The theory posits that the emergence of entrepreneurs in a society as well as the way they make decisions is determined by sociological factors (Hisrich *et al.*, 2007; Khanka, 2007; Singal, 2009; Bwisa, 2011; Nteere, 2012). Thus, the past and present social conditions and environments may encourage or inhibit the emergence of entrepreneurs.

The influence of sociological factors on entrepreneurship is exerted through the process of socialization (Bwisa, 2011; Nteere, 2012). Socialization is the process through which individuals in a given society acquire values, attitudes and behaviour. It is the learning process through which individuals acquire culture and behaviour which is acceptable to their society. The socialization process is lifelong and starts very early in an individual's life. It is imparted by the family, religious organizations, peers, and schools as socialization agents.

A society that has a culture that honours entrepreneurs is more likely to get more and more entrepreneurs emerging than one that frowns on entrepreneurship (Dollinger, 1994; Nteere, 2012). Likewise, children who are exposed to entrepreneurship by family and relatives from an early age are more likely to become entrepreneurs than children who lack such exposure.

Microfinance institutions that choose to transform are encouraged by their peers as they interact under the ambit of the Association of Microfinance Institutions in Kenya (AMFI). This is evident because, as Mutai (2008) notes, AMFI lobbied for the enactment of the Microfinance Act for many years on behalf of its members until 2006 when it was eventually enacted. As AMFI was lobbying, it continued providing forums for members to interact, interrogate and get more informed about the benefits of MFIs transforming.

2.2.4 Capital Theory and MFI Transformation

The other theory that guided this study was the capital theory. Capital is a type of good that can be consumed now, but if consumption is deferred, an increased supply of consumable goods will be available later (Bwisa, 2011). It is that part of a person's stock which he expects to give him revenue. That is why economists term capital as one of the factors of production.

It has been argued that microfinance increases the financial capital of the beneficiary enterprises (Hulme & Mosley, 1996; Hulme, 2000). This is because the loan borrowed provides entrepreneurs with the means to invest in an income-generating activity, thereby providing them with the chance to increase their financial capital.

However, previous research is not conclusive on the relationship between access to microfinance and increase in financial capital. First, the available literature suggests that the actual impact is highly dependent on the level of income. For instance, the poorest borrowers seem not to achieve a sufficient income increase (Hulme & Mosley, 1996; Hulme, 2000). Nevertheless, as Khandker (2005) found out, access to microfinance contributes significantly to poverty reduction, especially for poor women. Secondly, the effectiveness of increasing financial capital through micro-credit depends on the interest rates microfinance institutions charge (Hudon, 2006). If the interest rates are high, the net capital accumulation accrues to the lender rather than the borrower. Finally, the effectiveness of increasing financial capital through micro-credit depends on whether the loan is used for productive or non-productive purposes. For instance, financial capital is decreased whenever the micro-credit is used for consumption rather than investment (Hulme, 2000). Whenever micro-credit

is not used to invest in an income-generating activity, no additional means are generated to repay the loan. In this case, the borrower may end up using the existing capital to repay the debt, thereby reducing, rather than increasing, his capital stock. Therefore, the effect of microfinance on financial capital depends on the income level of the borrowers, how the loan is used and on the interest rate charged by microfinance institution (Vanroose, 2007).

The capital theory was considered relevant to this study on transformation of MFIs into deposit taking financial institutions because of the linkage between microfinance and capital formation as discussed above. Indeed, one of the factors that led to the emergence of microfinance in the 1970s was the challenge faced by the poor and small enterprises in accessing credit and other financial services. At core of the transformation of MFIs into DTMs is the need to reach more of the poor and small enterprises with a variety of microfinance services in a sustainable manner.

2.2.5 Human Capital Theory and MFI Transformation

Human capital is the stock of productive knowledge, education, experience, and skills possessed by workers or entrepreneurs which allows them to receive a flow of income. It has been argued that there is a positive relationship between human capital and success (Unger, Rauch, Frese, & Rosenbusch, 2009). This is because human capital increases owners' capabilities of discovering and exploiting business opportunities. Human also capital helps owners to acquire other utilitarian resources such as financial and physical capital, and it assists in the accumulation of new knowledge and skills.

It has further been argued that access to microfinance enhances an entrepreneur's human capital. However, this depends on the approach adopted in the provision of microfinance - that is, the poverty lending approach (also referred to as credit-only, micro-credit, minimalist or institutional approach) or financial system approach (also referred to as integrated, "microfinance plus, or welfarist approach) (Robinson, 2001). According to Karlan and Valdivia (2007), the provision of credit and educational services influences both the level of human capital of the clients and that of their children. Therefore, one can conclude that integrated microfinance programs do increase the level of human capital. In addition, increased financial income leads to better education (Maldonado, González-Vega & Romero, 2002). Through increasing income, microfinance could thus help improve education levels. Nevertheless, as mentioned above, particularly amongst the "poorest of the poor", the level of income increase resulting from micro-credit may not be sufficient to make a real difference.

The human capital theory was thus considered relevant for this study. This is because the aim of transforming microfinance is the creation of sustainable microfinance institutions that will be able to reach more clients with a wider range of products and services. This entails adopting the financial systems approach to the provision of microfinance services.

2.2.6 Stakeholder Theory and MFI Transformation

The stakeholder theory holds that there are interconnected relationships between an organization and various entities that have a stake in the organization (Miles, 2012). These entities include employees, customers, investors, suppliers, and communities (Gichira, 2005; Richman, 2008; Mulwa, 2008; Gitonga, 2010).

Traditionally, business enterprises are duty bound to consider the needs of their owners first and to increase value for them (Miles, 2012). The owners are the shareholders or stockholders. In older input-output models of a business firm, the firm converts the inputs of investors, employees, and suppliers into outputs that are sold to customers buy. By this model, firms only address the needs and wishes of investors, employees, suppliers, and customers.

However, the stakeholder theory recognizes other parties like governmental agencies, political groups, trade associations, trade unions, communities, employees, customers, and the public at large (Gichira, 2005; Richman, 2008; Mulwa, 2008; Gitonga, 2010). Indeed, even competitors are sometimes counted as stakeholders. The theory, therefore, posits that a business enterprise should create value for all stakeholders, not just shareholders or financiers.

Pursuant to this theory, a transforming MFI should consider the interests of various stakeholders. This is because, governmental agencies, political groups, trade associations, trade unions, communities, employees, customers, and the general public all have an interest in the success of the MFI. Likewise, employees have an interest in the security of their jobs. They might be apprehensive of losing the jobs in the ensuing reorganization of the MFI.

2.2.7 Agency Theory and MFI Transformation

According to Mersland & Strom (2007), agency theory argues that there are agency costs stemming from the separation of ownership and control of a firm. These costs

can be minimized depending on how ownership is organized and practised. According to this theory, owners with financial incentives are more able to reduce agency costs. This means that in ownerless non-profit organizations like NGO MFIs, agency costs are higher. However, agency theory also predicts that the non-profit organizations can have an offsetting benefit of reducing customer adverse selection and moral hazard since they may be closer to the customers and better able to tap into local information networks.

In microfinance where customers generally have lower levels of education, it makes good sense that Macey and O'Hara (2003) suggest that the relationships with depositors and borrowers are as important to the success of the bank as the manager's and the board's relationship with its owners. Furthermore, in microfinance where donors are major stakeholders, the principal-agent relationship can equally be applied to the relationship between the MFI and the donor. Donors may have more problems entrusting their money to MFIs owned by profit motivated investors. Therefore, agency costs in microfinance have a multiple nature, one between owners and managers, one between the MFO and its customers, and one between the donors and the MFO.

Donors and other financial partners continue funding an MFI from its inception without becoming owners (shareholders). Upon transformation, the organization that they have been supporting without bothering about ownership must now get owners in order to satisfy the regulatory requirements. Such donors may have more problems entrusting their money to the new DTMs owned by profit motivated investors. This

study on transformation of MFIs in Kenya was, therefore, also guided by agency theory.

2.3 Approaches to Provision of Microfinance and Models of MFI Transformation

2.3.1 Approaches to Provision of Microfinance

The revolution of microfinance has taken place over less than 40 years to date. During that period, two approaches to the provision of microfinance have emerged, namely, the poverty lending and financial system approaches (Robinson, 2001). While the poverty lending approach promotes donor-funded credit for the poor, the financial systems approach promotes the provision of credit and other financial services to the poor on a commercial basis by institutions that are self-sustaining. A description of the two approaches is summarized in Appendix 5.

The two approaches are similar in at least one major respect, namely, their aim. The aim of both approaches is to reduce poverty through improved financial inclusion, which means attaining higher levels of access to financial services by the population (Rhyne, 1998; Robinson, 2001). However, they differ in many aspects, including the nature of players, their sources of resources, level of formality, and their regulation and supervision.

Poverty lending was the principal approach during the initial years of microfinance development. The approach focused on providing only financial credit to the poor, especially the poorest, mainly for the purpose of reducing poverty (Rhyne, 1998). The focus was thus on micro-credit rather than microfinance. The service (micro-credit)

was provided mainly by micro-credit projects and institutions that were set up by NGOs, government agencies, and religious and other non-profit making charitable organizations.

The service providers under the poverty lending approach were highly constrained in terms of their ability to mobilize financial and other resources (CGAP, 2000). Since such organizations did not have shareholders, and thus no share capital, the poverty lending approach promoted, inevitably, the reliance on the use of donor funds and grants from governments and other sources in providing credit.

This resulted in unsustainable institutions that had weak governance and management structures. It also resulted in unsustainable service provision and limited capacity of the providers to expand their reach, thereby perpetuating financial exclusion of a majority of the population, especially the poor.

The financial systems approach, which evolved from the poverty lending approach, promotes commercial microfinance for the poor and other, subsidized and charitable non-financial methods of reducing poverty and creating jobs for the extremely poor. It also entails provision of other financial services like savings, insurance, money transfer, and low cost housing in addition to financial credit. The financial services are well-matched with the real needs of clients.

The financial systems approach also propagates for the provision of services commercially by many competing, self-sustaining institutions. When services are provided commercially, it means that the cost of providing them is not subsidized and

the clients are charged the full cost (Ledgerwood, 1999; Ndambu, 2011). A self-sustaining institution is one that has attained, among others, financial sustainability. Such an institution is able to remain in operation even if donors or governments are no longer willing or able to subsidize them. To reach this level, the institution prices the financial services so that all the costs are covered. The competition forces the institutions to operate efficiently in order to minimize costs while maximizing the returns.

Under the financial systems approach, microfinance institutions mobilize resources from a variety of sources so that their financing consists of both equity and debt capital. Their resources thus include shareholders' capital contribution, commercial funds, public deposits, and other income. Therefore, the service providers are formal regulated microfinance institutions (CGAP, 2000).

The successful adoption of the financial systems approach or commercialization to microfinance results in increased reach, both in terms of the number of target clients and the number of different financial services provided. It also leads to the development of sustainable - that is, commercially viable - microfinance institutions and, consequently, to the sustainable provision of financial services. Together with the development of an appropriate legal and regulatory framework, this makes the microfinance sector attractive to more institutions, including commercial banks. The ensuing competition leads to improved provision of services. Overall, it increases the level of financial inclusion in a country.

The achievement of a full financial systems situation is constrained by the inappropriate legal and regulatory framework for the microfinance sector found in many countries, or a complete lack of it in others (Robinson, 2001). Microfinance institutions thus have the option of becoming formal and regulated either under the existing banking legal framework, or to lobby for, and work with the country regulatory authority to develop, a specific framework for the regulation and supervision of microfinance. The adoption of the financial systems approach to microfinance is further constrained by the challenges faced in the process of transforming into regulated microfinance institutions.

Despite its duration being relatively short, the microfinance revolution has already reached the stage where many countries are making efforts to ensure that financial services for the economically active poor are implemented on a large scale (Robinson, 2001). The challenge of microfinance is to build a world in which as many poor and near-poor households as possible have permanent access to an appropriate range of high-quality financial services (Christen *et al.*, 2004). This vision involves four dimensions. These are: breadth of outreach (providing access to as many people as possible); depth of outreach (reaching as far down the income scale as practical); service quality (offering a suitable variety of financial products such as savings, loans, remittances, and insurance that are well-matched with the real needs of clients); and, financial sustainability (pricing financial services so that their costs are covered and they do not disappear when donors or governments are no longer willing or able to subsidize them). This entails adopting the financial systems approach to microfinance. To achieve this, NGO MFIs need to transform into deposit taking financial

institutions. The challenges faced during that transformation is the subject of this study.

2.3.2 Models of MFI Transformation

Transforming MFIs from NGOs into regulated financial institutions has become more and more appealing to an increasing number of MFIs. This is due to its anticipated benefits, such as the ability to mobilize public deposits, access to private sources of capital, and improvement in governance and transparency, with an ultimate goal to reach significant scale and financial sustainability (Hishigsuren, 2006). Transforming NGOs into regulated financial institutions started when Fundación para la Promoción y el Desarrollo de la Microempresa (PRODEM) became BancoSol in Bolivia in February 1992 (Campion & White, 1999; Microfinance Gateway, 2008). Since then, MFI transformation is rapidly spreading out. For instance, between September 1997 and the end of 2004, a total of 16 transformations were reported in Cambodia, India, Mongolia, Nepal, Pakistan, and Philippines.

In order to achieve the ultimate goal of reaching a significant scale (that is a large number of people) and financial sustainability, Christen and Rosenberg (2003) strongly argue that microfinance must eventually move into institutions that are licensed and supervised by a country's financial authorities. This movement toward commercialization and integration of microfinance into the formal financial sector can be achieved through one or a combination of several models which have been tried out in different countries.

According to Hishigsuren (2006), worldwide, transformation is taking four institutional models. The first model is where a Microfinance NGO transforms into a commercial entity that is regulated by the country's regulatory authority, usually the central bank. The new entity could be a non-bank financial intermediary or a commercial bank. For example, BancoSol in Bolivia, K-Rep and Jamii Bora in Kenya, CARD Bank in the Philippines, BRAC in Bangladesh, Mibanco in Peru, Finsol in Honduras and Compartamos in Mexico used this model. The new entity could also take the form of a deposit taking microfinance institution (DTM) like KWFT, SMEP, and Faulu in Kenya (Republic of Kenya, 2006). This is the model envisaged by the Microfinance Act in Kenya.

The second model is where traditional, regulated financial institutions penetrate the microfinance market (Chiumya, 2006; Hishigsuren, 2006). Such institutions may be large retail banks, including state-owned institutions, small commercial banks, finance companies and credit unions. For example, Sogebank in Haiti, BRI in Indonesia and Banco Pichincha in Ecuador transformed in this model by creating subsidiaries to provide microfinance services.

The third model entails the creation, from scratch, of commercial microfinance institutions (Chiumya, 2006; Hishigsuren, 2006). For example, Bangente in Venezuela was created as a commercial financial institution from the start, while IPC is setting up "microbanks" in Eastern Europe. The Microfinance Act in Kenya also provides for registration and licensing of new DTMs (Republic of Kenya, 2006).

The last model involves a merger between a commercial bank and a microfinance institution, or merger between two or more microfinance institutions (Chiumya, 2006; Hishigsuren, 2006). For example, CONFIE in Nicaragua and Genesis in Guatemala have incorporated into the commercial operations of an existing small commercial bank or finance company, while XAC and Gobi Ehlel, both of which were independent microfinance NGOs in Mongolia, have merged into one regulated microfinance institution.

The above four institutional models can be grouped into two broad categories. The first one is where existing traditional financial institutions are encouraged to start providing microfinance services. This means that they start to include lower income markets in their target market. This is referred to as downscaling. The other category is where existing MFIs, especially those from the NGO sector, convert into regulated financial institutions and completely new ones are registered as such.

Moving microfinance into regulated institutions presupposes the existence of an appropriate legal framework in a country. A difficulty arises because in most countries the existing legal framework consists mainly of laws and regulations that are suitable for the formal banking sector. As microfinance is different from conventional banking, an adjustment to the existing regulatory framework and / or the development of laws and regulations suitable for microfinance becomes necessary in many countries (Christen *et al*., 2004; Sushanta, 2011). The logical consequence has been to convert the existing MFIs into regulated institutions once a given country has put in place an appropriate legal and regulatory framework.

There are three events in the transformation process (Campion & White, 1999; Frank, 2008; Sushanta, 2011). The first one is the granting of a licence to the MFI by the regulating agency in the country (which is usually the central bank). The second event is the introduction of ownership, usually through stock issuance. The third phase consists of several activities of organizational development which might take much longer than any of the other two. The events, and the order in which they are undertaken, differ from country to country (Hishigsuren, 2006).

In addition, depending on the country in question, the processing of licenses may be done in one of two ways. One way is where an MFI seeking to be regulated selects an institutional structure based on the current banking legislation. The other way entails MFIs working with a supervisory agency to develop a special regulatory legislation for institutions providing microfinance services.

However, a mix of the two ways in a single country is also possible. For example, in Kenya, K-Rep and Equity Building Society were licensed within the existing banking law as they converted into commercial banks. At the same time, MFIs worked with the Central Bank of Kenya to develop a specific law and regulations for microfinance. According to Mutahi (2008), the microfinance sector, through the Association of Microfinance Institutions (AMFI), worked hard for many years for the law to be enacted. Besides, even after a microfinance legal framework has been put in place, some MFIs may still chose to transform into banks but retain microfinance as their major product offering. This is the case with Jamii Bora in Kenya.

2.4 Conceptual Framework

A conceptual framework is the diagrammatic presentation of variables and it illustrates the relationship between the independent and the dependent variables (Chandran, 2004; Oso & Onen, 2009). It is a schematic representation of a research problem that includes a network of concepts, that is, factors or variables, and shows the flow and direction of their relationships. Thus, a conceptual framework exhibits which concepts are related to which others and the direction of those relationships. The variables which influence other variables are called independent variables while those which are influenced by one or more independent variables are called dependent variables.

The conceptual framework for this study presents the variables that were identified from the available relevant literature as challenges affecting the transformation of MFIs into deposit taking financial institutions. Transformations raise a host of issues that an MFI needs to address (Ledgerwood, 1999; Lauer, 2008; Sushanta, 2011). They include decisions on the type of institutional structure, institutional growth and transformation, ownership and governance, funding and institutional capacity. However, it is often not easy to understand the complicated issues involved in switching from an MFI, which is an ownerless entity, to a DTM, which has owners, before the transformation process is initiated. Whereas the issues and challenges arise before, during and after transformation (Hishigsuren, 2006), this study focused on the challenges faced during the transformation process – from the planning phase until the time when an MFI is issued with a license.

This study had one dependent variable and four independent variables. The study made the assumption that there was no intervening or moderating variable(s), that is, there were no important variables that were omitted. This assumption was essential because it is one of the necessary assumptions that must be made when a study has to use logistic regression analysis, as was the case with this study (Morgan & Griego, 1997; Pallant, 2007; Nicol & Pexman, 2010). The other key assumptions of logistic regression are that there are no outliers, true conditional probabilities are a logistic function of the independent variables, the independent variables are measured without error, observations are independent (no singularity), the independent variables are not linear combinations of each other, and that there is a large enough sample. Finally, there is an assumption on multicollinearity that there is no redundancy among the independent variables. This means that the predictor variables are strongly related to the dependent variable but not strongly related to each other.

Logistic regression was used in this study because it is the appropriate analysis technique to test models intended to predict categorical outcomes where the dependent variable is dichotomous or categorical as was the case in this study (Morgan & Griego, 1997; Pallant, 2007; Nicol & Pexman, 2010). The dichotomous dependent variable for this study was transformation status, with the outcomes being classified as either transformed (license) or not transformed (not licensed).

The challenges that were identified from the available relevant literature were grouped into four, which became the independent variables for the study. They are planning for transformation, legal compliance, management of stakeholders, and institutional change management. The dependent variable was transformation status.

The five variables are presented diagrammatically in Figure 2.1. This is followed by a critical review of relevant literature corresponding to each of the variables and presented from section 2.4.1 to section 2.4.5.

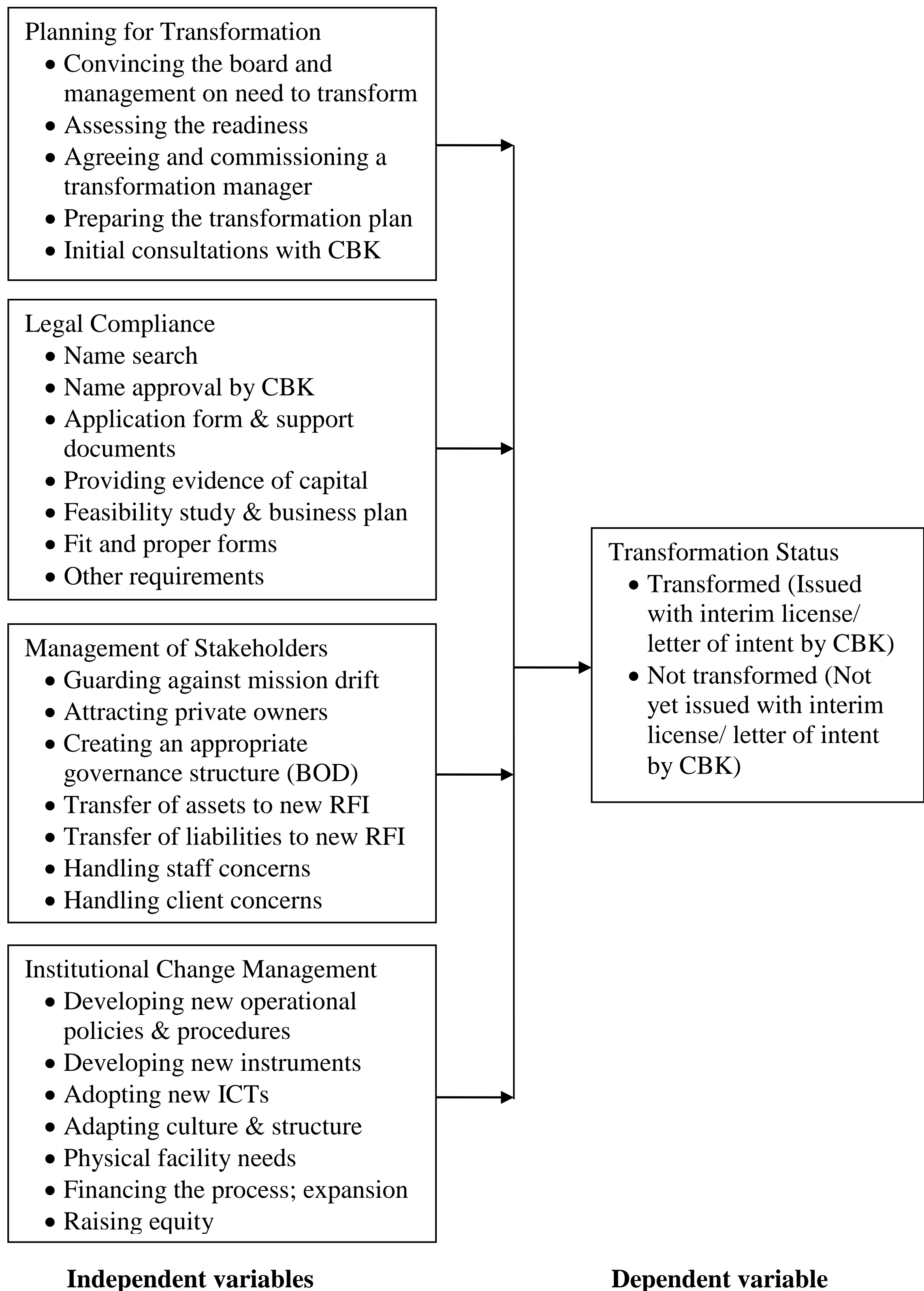


Figure 2.1: Conceptual Framework

2.4.1 Planning for Transformation as a Challenge

According to Ledgerwood and White (2006) and Rosenberg (2010), transformation entails numerous changes including the legal status, provision of multiple products, mobilization of voluntary savings and compliance with regulatory requirements. Transformation is thus not a mere change in the legal form of the MFI but rather it requires a complete cultural and operational transformation, which calls for comprehensive prior planning.

The initial consideration in the planning is to secure an agreement from the board and senior management on the need to transform. This is important because an MFI needs to review its mission and vision to ensure that it is in line with the expected deposit taking status. Getting this agreement is considered so critical that Ledgerwood and White (2006) and Frankfurt School of Finance & Management (2012) argue that without it the plans for transformation should be abandoned or put on hold until such a time that the key people in the MFI reach an agreement. This matter has been a challenge in the transformation when the board and senior management either fail to agree on the need to transform or take too long to agree.

Another planning challenge to transforming entities is the assessment of the readiness to transform. This is because there are numerous strategic issues to be considered and decisions to be taken at the planning stage (Ledgerwood & White, 2006; Frankfurt School of Finance & Management, 2012). Another issue for assessment is whether the MFI is prepared emotionally and financially to substantially develop its capacity so as to become a true financial intermediary. This is complicated by the question of how much control the MFI is willing to give up, the structure of the board of the DTM in

terms of the number of board members and the number of board committees and whether the MFI will continue to exist and what its role will be. This includes decisions on whether the NGO will take shares in the new DTM, and how many the shares will be and the role of the founders of the MFI in the governance of the new DTM. Another issue to be assessed is whether or not there exists adequate management and staff skills and capacity required of a true financial intermediary; and whether the MFI is ready to hire externally if the available capacity is inadequate. In addition, decisions have to be made on the adequacy of the current board to oversee the transformation process and whether the board has the capacity to oversee a financial intermediary. Finally, the willingness to open up to outsiders regarding MFI operations as well as the willingness to seek technical assistance where the capacity is inadequate has to be assessed. This assessment has not been easy and often requires the assistance of external consultants (Hudson, 1995).

Transformation requires a strong change agent (Denhardt, Denhardt & Aristigueta, 2002). Therefore, central to the initial planning is the need for a transformation manager – a champion to lead the process and ensure consensus building amongst the key stakeholders. Transforming MFIs face difficulties identifying such a person, who should ideally be a senior person from within the MFI. Internal power and politics make it difficult for organizations to quickly agree on who the change agent should be. It could also become a challenge when the transformation manager selected turns out to be incompetent or not to be enthusiastic about transformation. This will ultimately delay the process with the possibility of completely derailing it.

As part of the planning, transforming MFIs require a well prepared transformation plan. The challenge is that this plan should take into account everything that the MFI needs to consider to become a financial intermediary (Rosenberg, 2010; Frankfurt School of Finance & Management, 2012). The plan outlines the "one-off" activities that need to take place to develop the capacity of the NGO to be licensed to take deposits. The plan shows where the organization is today, where it needs to be to not only comply with central bank regulations, but also to be a successful, profitable deposit-taking financial intermediary. It finally shows what needs to be done to get from point A to B. Preparation of transformation plan is also not easy and often requires the assistance of external consultants (Hudson, 1995).

The last aspect of planning as a challenge for transforming MFIs is the initial consultations with the regulator, that is, CBK in Kenya. The consultations need to start early so that the MFI will be able to understand the specific requirements for transformation in terms of procedure and documentation. This has presented challenges where the MFI starts the consultations late or the relationship between the sector and the regulator is not very friendly (Chiumya, 2006); Mutahi, 2008).

2.4.2 Legal Compliance as a Challenge

According to Hishigsuren (2006), when seeking to be regulated, transforming MFIs have two options with regard to the process to follow if this happens before a specific law for deposit taking microfinance institutions does not exist. One of the options is to be licensed under the banking laws and regulations existing in their country. This is the option that the former K-Rep and Equity Building Society took and they got registered under the banking law to become K-Rep and Equity bank respectively. The

other option is for MFIs to work with the country's supervisory agency to enact special regulatory legislation for institutions providing micro-finance services – especially in countries where MFIs became ready for regulation before the supervisory agency. The latter is what happened in Kenya after the K-Rep and Equity experiences, resulting in the enactment of the Microfinance Act in 2006. Since the enactment of this law, several of the MFIs have sought to transform within this framework into DTMs, a special category of regulated deposit taking financial institutions.

Studies carried out in other countries suggest that the licensing process was the most difficult aspect of transformation for most institutions (Hishigsuren, 2006; Frankfurt School of Finance & Management, 2012). A relatively long period of time (2-3 years) was taken to complete the licensing process as the regulations usually require MFIs to make internal improvements in areas like internal control, reporting capabilities, branch physical security, and finding an acceptable ownership and management structure. The timeframe, however, could even be longer and it seems to depend on the legal and regulatory environment existing in a country. For example, while transforming into a commercial bank in Kenya, K-Rep had initially expected to be issued with a license within 3 months. Yet it took much longer because of the requirements of the banking laws and other factors at the time, like a banking crisis that even led to the closure of five small banks and a run on one big bank (Campion & White, 1999; Ndambu, 2011). Since transformation within the Microfinance Act 2006 is a fairly recent phenomenon, the period required for licensing has not yet been documented.

Some transforming MFIs have had difficulties in meeting the legal requirements of an acceptable ownership and management structure (Hishigsuren, 2006; Lauer, 2008). An MFI that fails this 'fit and proper' test is denied registration because banking authorities may not be willing to license certain kinds of contributors. For instance, the approval may be denied if the original NGO owns a major shareholding in the proposed MFI. The local law may prohibit an NGO from selling its loan portfolio or exchanging it for shares in the proposed MFI. Even if the law allowed the loan portfolio to be contributed as capital, the regulations may not recognize it as "tier 1" capital for purposes of determining capital adequacy. In addition, the transfer or valuation of the other assets like employee contracts and intangibles may be difficult. Approval may also be denied or delayed with regard to the participation of foreign institutions like donor-related institutions and international microfinance institutions. The same applies for senior managers lacking conventional banking backgrounds even though they may have immense microfinance experience.

In Kenya, the Microfinance Act 2006 and Regulations spell out the process and licensing requirements for a deposit-taking microfinance (DTM) institution (Republic of Kenya, 2006; Republic of Kenya, 2008). Pursuant to the requirements of the Act, the Central Bank of Kenya (CBK) developed and published guidelines on the licensing process and documentation requirements to assist potential investors, promoters or other interested parties, and transforming entities in applying for a deposit-taking microfinance business license (Republic of Kenya, 2008). The guidelines split the licensing process into three broad stages, namely, approval of the name, application for license and meeting documentation requirements, and finally

the issuance of letter of intent and license (CBK, 2008). These stages and the documents that should be submitted at each stage are highlighted next.

a) Stage one: Approval and Registration of Name

The first step for an MFI seeking to transform into a deposit-taking microfinance institution (DTM) under the Microfinance Act 2006 is to propose and book at least three names with the Registrar of Companies and Business Names. Names that have close similarities to existing institutions which may cause confusion, or those that may offend the public or lean towards religious, political, or ethnic inclinations are not acceptable.

The applicant is then required to submit the names to the CBK in order to obtain a letter of no objection. Once the proposed name is approved by CBK, the applicant can proceed to incorporate, or change the name of the company. The applicant should incorporate the words "Deposit Taking Microfinance" or "DTM" in the company's name.

b) Stage two: Application for License and Documentation

The second stage entails the institution completing and submitting an application form with supporting documents attached, duly certified as true copies of the original by a commissioner of oaths or public notary. The copies of documents to be attached include Certificate of Incorporation, Tax Personal Identification Number (PIN) Certificate, Registered Memorandum and Articles of Association indicating the core capital, verified Official Notification of Company's Registered Place of Business and the prospective places of business (head office and, branches, agency and outlets, if

any). One should also attach payment (banker's cheque) for the appropriate non-refundable application fee.

In addition, the applicant is required to prepare and submit evidence of ability to meet the minimum core capital requirements (e.g. a bank statement) - Ksh 20 million or Ksh 60 million for community and nationwide microfinance institution respectively. The applicant must also submit a comprehensive feasibility study accompanied with documents for vetting, that is, "Fit and Proper Forms" and supporting documents for all the significant (at least 10% of shareholding) individual and corporate shareholders. In the case of a foreign subsidiary, a copy of board resolution, historical background, and a signed declaration to adhere to the laws of Kenya are required. The CBK will further obtain a letter from the Home Supervisory Authority. Finally, the applicant should submit Board and Annual General Meeting (AGM) resolution approving the proposed business plan, copies of audited financial statements of the last three years, and a due diligence report prepared by an external audit firm on the operational and financial performance of the MFI (particularly reviewing the adequacy of the management information system (MIS) and internal control systems).

c) Stage three: Letter of Intent

The CBK then issues a letter of intent, which is approval in principle, issued upon fulfilment of stage 1 and 2 requirements. The letter advises the applicant on the next steps and requirements to be fulfilled before issuance of a license and approval to commence operations. These include the payment of license fees, preparation of premises for inspection and approval, moving capital funds to the company, fit and

proper forms and supporting documents for purposes of vetting and approval of proposed officers.

The applicant is further required to put in place appropriate structures and systems to operationalize the business. These include governance structures, deposit mobilisation strategies, MIS and infrastructure, operations manuals and risk management policies and internal control systems.

If satisfied that the institution has fulfilled all the requirements, the CBK may issue a license and the DTM may start operations. The CBK, within 14 days, publishes the name of the newly licensed institution in the Kenya gazette as a deposit-taking microfinance institution.

It is apparent from the above outline of the licensing process that in order to meet the CBK requirements, there are activities that an MFI should undertake prior to making the application for licensing and others that it should undertake during the licensing process itself. One can expect a transforming institution to face various challenges while undertaking the activities at any of the phases. Whereas the process appears linear and simplistic, the stringent requirements make it necessary for applicants to move back and forth to complete the activities. Indeed, it appears prudent for a transforming MFI not only to reach out to CBK to walk along with it but also to strive to meet most of the requirements before applying for licensing. It is for this reason that this study sought to assess, not only the challenges likely to arise from the licensing process, but also those related to the preparations that an MFI is expected to undertake before applying for a license.

2.4.3 Management of Stakeholders as a Challenge

The management of a transforming MFI is faced with the difficult task of responding to the concerns and expectations of various stakeholders. One of the concerns is the apprehension by stakeholders that the MFI's original vision and mission of targeting the poor might change in due course. This change of vision and mission is referred to as mission drift. This concern arises because of the dual nature of the goal of transformation, namely, large outreach and sustainability (Christen, Rhyne, Vogel & McKean, 1995; Wright, 2001). To reach large numbers of the poor, a transformed MFI must also seek to become sustainable (CGAP, 1996; Rhyne, 1998). As a transformed MFI grows, it is expected to start lending out larger loan amounts to meet the demands for commercial viability (Campion & White, 1999; Rosengard, Rai, Dondo & Oketch, 2000). The NGO stakeholders, therefore, have a legitimate concern about the possibility of a mission drift once the transformation, which entails a change in ownership structure and status, is complete (Lauer, 2008; Sushanta, 2011; Worth, 2012). This concern may delay the transformation process as the stakeholders seek assurance that their interests will not be comprised.

To deal with this issue, the management of a transforming MFI has to determine how best to ensure that there will be someone to ensure that the original mission is pursued once the NGO no longer has control over the new MFI and whether there will be shareholders with an equally strong interest in pursuing the original mission (Lauer, 2008). The transforming NGO MFI may also get into an agreement based on a consensus among shareholders that includes a statement on the mission of the company. However, this might not solve the matter fully because shareholder

agreements may not be enforceable in all countries. How successfully the management responds to these issues depends on the composition of the shareholders and how that composition is permitted or not permitted to change. These efforts might also may delay the transformation process.

Closely related to the above is the issue of corporate governance (Ledgerwood, 1999; Lauer, 2008). This is because, unlike an NGO MFI, a company is controlled by owners out to protect their private financial interests. On the other hand, an NGO MFI has no owners and depends on the social motivation of its governing body (Sushanta, 2011). A Board of Directors is necessary for the resultant regulated financial institution (RFI) and has the important role of determining how the new for-profit institution will grow, be profitable, and manage its risk while guarding against mission drift. The NGO MFI governing body might not easily agree to be blocked out of the board of the DTM which might further delay the transformation process and affect the transformation status.

Another challenge is that donors raise concerns regarding the use of funds (Campion & White, 1999, Hishigsuren, 2006). Since grant funding for NGO MFIs is generally meant to benefit poor and low income people by supporting the development of institutions that offer formal financial services to such people, some donors might be against the transfer of an NGO's assets to a private company. The existing policies and agreements might even be against such an eventuality. Thus, the management has the task of convincing such donors that using the funds to create a sustainable institution that is able to serve more of the beneficiaries is just another strategy to accomplish the primary purpose of increasing access to financial services by the poor.

The NGO should be compensated, for example with shares or other value in exchange for its transfer of assets to the new institution, for the transfer as has happened in most donor approved transformations (Lauer, 2008). However, the pricing of the shares should be done in such a way as to ensure a fair transfer of the NGO's assets, including grant funds, to private parties. Convincing the NGO MFI donors that using the funds to create a sustainable institution that is able to serve more of the beneficiaries is just another strategy to accomplish the primary purpose of increasing access to financial services by the poor may take a while, leading to further delays in the transformation process.

Another challenge regards the transfer of liabilities by an NGO MFI to the transformed institution (Lauer, 2008; Frankfurt School of Finance & Management, 2012). It is necessary to consider the implications of transferring to the transformed institution by the NGO MFI an asset that might be having debt or other contractual encumbrances. It is also necessary to decide whether any existing external liabilities will be assigned to and assumed by the new company or will remain with the NGO. Lauer (2008) argues that while the debt liabilities may stay with the NGO if the lenders agree, few lenders will want to be left in a situation where they can only recover from the NGO, yet the latter will have transferred its loan portfolio - the principal source and guarantee of repayment - to another entity. Reaching this consensus takes time, thereby delaying the transformation process.

A transforming institution may also face the challenge of preparing its clients for the transition (Campion & White, 1999; Sushanta, 2011). The transforming organization must consider how best to communicate the expected institutional changes and what

implications they are likely to have on clients. It must consider how the existing clients will be transitioned without interrupting the current activities. In addition, it must consider the criteria for transferring the existing clients to the new entity. These decisions can come with varied levels of challenges. For example, Mibanco decided to take over 80% of the portfolio, considering the rest to be non-creditworthy due to default histories of the concerned clients. Dealing with the affected clients' concerns causes further delays in the transformation process.

One of the objectives of transforming into a regulated microfinance institution is to increase outreach, that is, for the institution to reach more low income people. This gives rise to the challenge of financing the expansion of operations (Campion & White, 1999; Ndung'u, 2010). These include new banking infrastructure, staff, monitoring systems and communication. These are exacerbated by downscaling by existing commercial banks which introduces more competitive pressure on the transforming MFI. Raising funds to finance the expected expansion of operations requires time, which also contributes to further delays in the transformation process.

Another category of stakeholders whose interests the management needs to address is the employees. With transformation, the new MFI may be required by operational and legal demands to incorporate experienced bankers, human resource managers, experts in asset and liability management, and management information systems specialists (Campion & White, 1999; Rosengard, Rai, Dondo & Oketch, 2000). This prospect is likely to cause a lot of anxiety amongst the existing staff, especially regarding job security. MFIs like K-Rep and Mibanco responded to this by engaging the existing staff in dialogue, capacity building and ultimately retaining most of them. Depending

on the intensity, more or less time may be required to sort out the staff concerns which could either prolong or hasten the transformation process. This ultimately affects the transformation status.

2.4.4 Institutional Change Management as a Challenge

As much as the importance of change in organizations is appreciated, it is also important to recognize that for most people change is very difficult (Denhardt *et al.*, 2002). The introduction of change in organizations thus naturally elicits resistance from various stakeholders. This is particularly serious when the new ideas appear to have the potential to challenge the existing organization. Some of the resistance might be based on emotional and psychological reactions while others might be based on objective reasoning. Whatever the case, resistance to change presents challenges that can derail the whole transformation process and, therefore, one that the management must deal with.

Transformation necessitates the development of an appropriate physical and operational infrastructure. Although this is sometimes done to meet legal requirements, in other cases it is based on the demands of operations (Campion & White, 1999; Sushanta, 2011). For instance, in order to keep the cost and risk of lending low, BancoSol retained the technology of personalized contact with the clients. This includes simple procedures and instruments tailored to suit the clients' demands. New accounting and passbook and savings software systems also need to be installed. The development of the appropriate physical and operational infrastructure requires money and time. It may end up delaying the transformation process and thereby affecting the transformation status.

Since a key objective of transforming is to reach as many people as possible at minimal costs, a transforming MFI is faced with the challenge of deciding on how to make use of information and communications technology (ICT). The innovative use of information and communications technologies can reduce the transactions costs and aid in the delivery of a wide range of financial services (Ivatury *et al.*, 2006). These may help to make an MFI more efficient in serving poor people. The most commonly used technology channels include automated teller machines (ATMs), point of sale (POS) card readers and mobile phones to handle transactions for poor customers. Some MFIs use new technology to serve their existing customers better while others hope to reach new clients in areas where setting up a physical bank branch may be too costly. The decision to adopt, install and use ICT can be quite demanding both in terms of time, money and other resources. This also might hasten or slow the transformation process, and ultimately affects the transformation status.

According to Campion and White (1999) and Sushanta (2011), a transforming institution faces the challenge of adapting its organizational structure and culture as BancoSol did. This is because the structure and culture should be able to support the methodology and operations of the new MFI. For example, before creating BancoSol, PRODEM had an informal internal culture appropriate for its lending methodology that was based on trust between it and clients. This culture encouraged innovation, commitment to the organization's mission, and recognition of individual contributions to a team effort. The management structure was simple and flat, relying heavily on interpersonal relations. The informal culture had to be changed in order to support the integration of new staff and branches. As BancoSol grew into a larger organization, it

required more standard lines of authority and communication and a more businesslike approach to decision-making. Ultimately, BancoSol designed a stricter management structure, improved systems, and new chains of command. Adapting its organizational structure and culture may prolong the transformation period, thereby affecting the transformation status.

Another aspect of infrastructure that is reported to pose challenges to transforming MFIs is the physical facilities like premises (Campion & White, 1999; Ndung'u, 2010). This is because the regulator requirements dictate the kind of premises and facilities that are within acceptable standards. For example in the case of Mibanco, the regulations specified the kind of walls, doors, windows, and security systems to be installed. For the case of K-Rep, there were additional issues regarding the location as the banking laws in Kenya at that time did not allow banks to be located in slums and remote areas for security reasons. Depending on the time that putting up appropriate facilities takes, it may either hasten or prolong the transformation process, thereby affecting the transformation status.

At the same time, as Ledgerwood (1999) asserts, transforming MFIs are often limited by a lack of funding sources because of their institutional structures. This is because most of them were initially created as semi-formal institutions (as NGOs or some form of savings and credit cooperative). MFIs thus need to think beforehand about how to deal with the likely increase in financial pressures emanating from the transformation process and rapid growth thereafter. One option is to switch from donor funding to more expensive commercial loans and deposits. However, funds from such sources, especially commercial loans, come with a huge cost which might

impact negatively on the performance of the MFI in the long-term (Campion & White, 1999; Ndung'u, 2010). For example, Bancosol saw its cost of funds increase from 4% to 12% over the first three years (1992-1995) of its transformation. This arose from the holding back of the revenue generation capacity by the legal reserve requirements which saw the proportion of assets placed in high-return loan portfolio reduced. Raising funds from public deposits can also be challenging for a transforming MFI as seen from the case of K-Rep in Kenya (Rosengard *et al.*, 2000). This is because whereas potential depositors may be confident about a fair return and safety of their savings, they may be apprehensive about the accessibility of their savings. This becomes an issue where a transforming MFI has had a well known policy on compulsory savings (using savings as collateral for credit) which restricts access by the saver. The ease of raising the funds may either hasten or prolong the transformation process, thereby affecting the transformation status.

Creating and / or increasing the capital base of an MFI is challenging in that a previously ownerless entity is now seeking owners (Ledgerwood, 1999; Ndung'u, 2010). The institution needs to decide whether to pursue institutional, individual, local or foreign investors or a combination of these options. The challenge goes even further because success depends on the willingness of the potential investors (Hishigsuren, 2006). For instance, K-Rep in Kenya sought institutional investors believing them to be more transparent with a longer-term commitment. K-Rep begun by seeking local institutional investors, but banks doubted its viability and declined, largely due to their lack of understanding of microfinance. Eventually K-Rep, with the assistance of donors, identified foreign investors. For PRODEM in Bolivia, raising equity was the most challenging aspect when creating BancoSol because commercial

micro-finance was a new concept. PRODEM settled for international and local investors. On the other hand, because of the low capital requirements of Philippine rural banks, CARD did not need to attract outside investment to fulfil minimum capital requirements. The initial increase in equity, the greater opportunities created by the transformation, and rapid growth in operations have resulted in continued growth in the total equity of some transforming institutions. For example FFP CLA, Compartamos, Mibanco, and ACLEDA Bank all managed to do this. The speed at which a transforming MFI is able to secure owners (investors) can hasten or slow down the transformation process, thereby affecting the transformation status.

The other institutional change feature that poses a challenge to transforming MFIs is the introduction of voluntary savings. With the introduction of voluntary savings, the MFI will no longer be able to control the number of clients. Secondly, the institution will have to expand its target market so as to include wealthier individuals and institutions in order to manage transaction costs. This requires a strong financial performance record and reputation. This calls for qualified management and staff, excellent internal controls, a robust MIS, banking halls, adequate security, and effective cash and asset/liability management. All these measures are necessary because with voluntary savings, the MFI will have the challenge of ensuring that the clients can trust it. Besides, the staffs need to learn new skills of approaching new clientele. The speed of designing voluntary savings products may also either hasten or prolong the transformation process, thereby affecting the transformation status.

2.4.5 Transformation Status

Transformation is the process by which an NGO MFI converts into a "formalized" or regulated financial institution (RFI) (Frank, 2008). The RFI may be established by way of a single nongovernmental organization (NGO) transferring all or part of its loan portfolio to the RFI (Fernando, 2004). It may also involve a group of NGOs transferring all or part of their loan portfolio to the RFI. The financial institution that is so created is regulated and supervised by the country's regulator, usually the central bank. The RFI is licensed to carry out deposit taking microfinance business.

A study by Hishigsuren (2006) shows that the process of MFI transformation has taken varying forms depending on the legal framework in a given country. For instance, it may take the form of an existing MFI converting into a RFI. It may also be in the form an existing MFI alone, or in collaboration with other organizations, establishing an RFI. Whatever the form it takes, it culminates in the application for registration as a deposit taking microfinance institution and finally being granted or being denied a license by the regulating authority to operate as such.

It is apparent from the above that several activities have to be undertaken during the process. Transforming institutions do undertake some activities even prior to, rather than concurrently with the application for a licence. Indeed, as Campion & White (1999) and Ndambu (2011) point out, the transformation of MFIs entails raising equity, institutional transition, and licensing. However, institutional transition, continues even after the institution is licensed. It is for this reason that Hishigsuren (2006) asserts that an MFI may experience challenges before, during and after the transformation.

An institution is considered to have transformed if it manages to overcome the challenges faced before and during the process of transformation until it is issued with a deposit taking license by the regulator. The transformation status is thus either that the MFI has transformed (been issued with a license) or not transformed (not yet issued with a license).

2.5 Empirical Review

A number of empirical studies have been carried out in the area of microfinance transformation as well as regulation and supervision. A study by Frankfurt School of Finance & Management (2012) documented the experiences of two microfinance organisations with transformation in Kenya. These are Faulu Kenya Ltd (Faulu) and Kenya Women Finance Trust (KWFT). The two MFIs transformed into deposit taking microfinance institutions (DTMs). The study paid a special focus on the planning and management, and the operational and structural aspects of transformation. The study found out that both MFIs transformed successfully and that transformation helped them to maintain their strategic positioning in the market.

However, in both cases, the process required more resources than initially planned and took much longer than expected (Frankfurt School of Finance & Management, 2012). In addition, the transformations raised greater than anticipated organisational challenges. The study concludes that transforming into a deposit taking institution is a huge task and that transforming MFIs must have a solid past. They need to start from strong foundations and continue to be well organized and flexible enough to keep aspirations focused when difficulties arise. They also need determined leadership,

dedication, excellent communication and a great deal of patience. Transforming MFIs also need to invest in staff training throughout the organisation, particularly in the use of new MIS, mobilising and managing deposits, and developing and marketing new products.

The above study by Frankfurt School of Finance & Management (2012) was found to be relevant to the current study as it provides useful in-depth insights into the experience of the two MFIs with transformation in Kenya. However, since it is a case study, the research findings may not be generalized to all transforming MFIs.

Another study undertaken by Nyerere, Mutua, Steele, Dondo and Kashangaki (2004) focused on the transformation of K-Rep in Kenya. Using the case study research design the study documented in detail the experience of K-Rep since its inception as a microfinance project, through transformation, and after the transformation. The study found out that K-Rep underwent transition twice. The first transition was in the late 1980s and was characterized by changing the institutional status from a project to an NGO. This involved changing the leadership from international managers to local microfinance specialists. The second transition was in the late 1990s and entailed the transformation from an NGO MFI to a commercial microfinance bank.

The study found out that one of the challenges that K-Rep faced during the transformation was mission drift posed by the need to find external investors for funding and expertise (Nyerere *et al*., 2004). The study also found out that since there was no specific law for MFI transformation at the time, K-Rep had to lobby and educate the regulators of the industry on the benefits of an NGO transforming into a

regulated microfinance commercial bank. In addition, the transformation presented a cultural shock for personnel as well as the operating systems. Besides, K-Rep hired new staff so as to meet regulatory requirements, introduce special training to resolve a culture clash between new and old staff, and restore morale and commitment by creating an employee stock ownership program. After managing the initial problems, the study found out that the transformation positive effects. For instance, within four years, the total number of borrowers and savers rose to over 90,000 from slightly over 15,000 at the time of transforming.

The above study by (Nyerere *et al*., 2004), was considered relevant to the current study because it reports in detail the experience of K-Rep with transformation in Kenya. However, being a case study, the research is not able to provide challenges of transformation that could be generalized for all transforming MFIs. Besides, K-Rep transformed at a time when Kenya did not have a specific regulatory framework for MFI transformation.

Another empirical study was carried by Chiumya (2006) in Zambia. The study sought to contribute to the understanding of regulatory and supervisory issues in relation to microfinance in order to inform the design of regulatory policy in Zambia, and other developing countries in sub-Saharan Africa. The thesis provides a critical evaluation of the potential impact of regulation on microfinance institutions, using the Zambian case.

The analysis is done first at the micro level to establish the potential impact of regulation and supervision on the three microfinance institutions licensed by the

supervisory authority during the period of the study (Chiumya, 2006). At the macro level, the analysis was extended to the entire microfinance sector. The study found that the regulation of the microfinance sector at the time of the study would have had a detrimental effect on the development of the microfinance sector and that the objectives for regulating the sector were unlikely to be met. Evidence from the study also suggested that the costs of compliance would have been considerable and would outweigh any potential benefits. The study concluded that the introduction of microfinance specific regulations would most likely result in regulatory failure. The study, therefore recommended that the existing regulatory framework at the time of the study be maintained.

A study by Ndulu (2010) was concerned that whereas many MFIs wanted to be allowed to mobilise public deposits, only three institutions had managed to obtain at least a provisional license two years after the regulation for microfinance became operational. The purpose of the research was to establish the factors affecting the microfinance transformation process in Kenya.

The study identified several important factors affecting the transformation process of microfinance institutions in Kenya (Ndulu, 2010). These include the ability to meet capital requirements, restructuring existing ownership and getting new shareholders, ability to raise funds for transformation, acquiring suitable information systems, motivation to be regulated, governance issues and managerial inertia. The study concludes that those factors explain why certain institutions moved faster than others in the transformation process and why some opted to remain credit only instead of transforming into deposit taking microfinance institutions. However, it is worth

noting that the study focused only on institutional transformation, thereby leaving out other aspects of transformation like legal compliance.

A study by Kiweu (2009) explored the circumstances under which African MFIs will consider commercial funding as a viable alternative source of funding. This study was necessary because as MFIs grow, they increasingly find themselves in need of additional capital to finance expansion of services to cover more poor communities. The study thus aimed at identifying the factors that are associated with successful access to private capital for MFIs. It examined the suitability of new opportunities for accessing fresh capital by MFIs for development and poverty reduction using commercialisation as an option.

The study found that certain critical success factors define minimum pre-conditions for microfinance institutions considering commercial funding as an alternative source of finance (Kiweu, 2009). The study results show that the extent of organisational formalisation and transparency in financial reporting are absolutely essential in drawing commercial lenders to invest in microfinance. The results further indicate that investors also look for larger, regulated and profitable MFIs as well as with a low-risk profile in an environment with low inflation levels for their investment portfolios.

2.6 Critique of Existing Literature Relevant to the Study

The review of the existing literature relevant to this study shows that various studies on the transformation of microfinance institutions have been carried out. The review shows that MFIs experience challenges before, during and after the transformation (Hishigsuren, 2006). However, most of the studies focused on the challenges faced after the transformation.

In addition, most of the studies have been carried out on MFIs that have successfully transformed, and usually, after the transformation (Rosengard, Rai, Dondo & Oketch, 2000; Ndambu, 2011; Frankfurt School of Finance & Management, 2012). As such, the challenges faced during the transformation process have been left out, making it difficult to learn of the challenges therein until studies are carried out well after transformation. This also means that the challenges faced by MFIs that fail to transform successfully, are likely to go undocumented.

The studies that have been carried out have mainly used the case study design. This is the case with the studies on K-Rep in Kenya (Rosengard *et al*., 2000), Faulu Kenya and KWFT in Kenya (Frankfurt School of Finance & Management, 2012), and Uganda Microfinance Limited (Drake, 2010). Case studies provide detailed information on the specific cases involved. However, they tend to be more descriptive and explanatory rather than predictive of phenomenon (Oso & Onen, 2009). It is thus more difficult to generalize from results of such studies.

2.7 Research Gaps

One of the research gaps determined from the critical review of the relevant literature regards the specific challenges faced during the transformation process itself until the time when the MFIs are granted a license by the regulatory body. The theoretical and empirical literature reviewed shows that numerous studies have been carried out on the transformation of microfinance institutions in Kenya as well as in other countries. However, most of the studies have focused on the challenges faced by MFIs after the transformation. Yet, like Hishigsuren (2006) points out, the studies show that transforming MFIs experience challenges before, during and after the transformation.

Another research gap regards the challenges faced during the transformation process. This is because most of the studies have been carried out on MFIs that transformed successfully. Moreover, the studies were usually undertaken after the transformation had been completed (Rosengard, Rai, Dondo & Oketch, 2000; Ndambu, 2011; Frankfurt School of Finance & Management, 2012). This has left out the challenges faced during the transformation process, making it difficult to learn of the challenges therein until studies are carried out well after transformation. This also means that the challenges faced by MFIs fail to transform successfully, are likely to go undocumented. This study sought to bridge those gaps by focusing on the MFIs when they were transforming regardless of whether they eventually succeed or not. In this way, the study generated knowledge on challenges faced by MFIs that had successfully transformed as well as those that were still transforming.

The other gap relates to the methodology. The studies carried out mainly used the case study design. Whereas case studies provide detailed information on the specific cases involved, they tend to be more descriptive and explanatory rather than predictive of phenomenon (Oso & Onen, 2009). It is thus more difficult to generalize from results of such studies. This study, therefore, sought to address those knowledge and methodological gaps by using a cross-sectional sample survey research design. This makes it possible for the results of the study to be used to predict the possibility of transformation from a given situation.

Another research gap is that the available empirical literature regards studies undertaken in an environment where a specific regulatory for microfinance transformation is missing. This is the case, for example, with the studies by Nyerere *et al*. (2004) and Chiumya (2006).

2.8 Summary

This chapter has presented a review of the literature relevant to this study. In the theoretical framework, the classical theories of entrepreneurship as well as relevant theories relating to MFI transformation were reviewed. The classical theories of entrepreneurship were economic, psychological and sociological theories while the theories relating to MFI transformation were capital theory, human capital theory, stakeholder theory and agency theory.

Concepts relating to MFIs, MFIs transformation and deposit taking financial institutions were reviewed. The review identified the approaches to the provision of microfinance services and the models of MFI transformation. The review identified

two approaches to the provision of microfinance services, namely, the poverty lending and the financial systems approach. The models of MFI transformation reviewed include the transformation of NGO MFIs into deposit taking financial institutions, downscaling by banks, and mergers between different institutions. This study was guided by the financial systems approach to the provision of microfinance and the transformation of NGO MFIs into deposit taking financial institutions model MFI transformation.

The conceptual framework which guided this study was also presented in this chapter. The conceptual framework presented the independent and dependent variables and was accompanied by a review of literature relating to the variables. The independent variables were planning for transformation, legal compliance, management of stakeholders, and institutional change management. The dependent variable, transformation status, was also reviewed.

A critique of the existing literature relevant to this study was undertaken. Consequently, research gaps were identified. The research gaps are on knowledge on microfinance transformation and methodology for studying the same.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter presents a description of the research methodology that this study used. It presents in detail the procedure used to answer the research questions by discussing the research design, target population, sample and sampling techniques, research instruments, data collection, and data analysis. Wherever deemed necessary and appropriate, the presentation and discussion in each section is backed by justification based on the expert opinion of scholars. The chapter is organized as follows: Introduction; Research design; Target population; Sampling frame; Sample and sampling technique; Research instrument; Data collection procedure; Data analysis and presentation; and, Test of hypotheses.

3.2 Research Design

A research design is the conceptual structure within which research is conducted (Creswell & Clark 2006; Kombo & Tromp, 2006; Kothari, 2012). It is the arrangement of conditions for collection and analysis of data in a manner that aims to combine relevance with the research purpose. It constitutes the blueprint for the collection, measurement and analysis of data. This study used the cross-sectional survey research design. This is a design that uses a representative sample of a larger population, with the hope of generalizing the findings to the larger population (Mugenda & Mugenda, 1999; Mutai, 2000; Orodho & Kombo, 2002; Orodho, 2004; Kothari, 2012). Data is collected once on the variables of interest and the researcher looks at the correlation between the variables. The cross section is always across the independent variables.

The use of the cross-sectional sample survey design facilitated the description and explanation of the variables in this study and their relationships in determining the transformation of MFIs into deposit taking financial institutions in Kenya. In addition, the design allowed the researcher to collect a large amount of data from MFIs which had already transformed and those that were still in the process of transforming into deposit taking financial institutions in Kenya. This design is perceived by many scholars as an authoritative and popular design in business and management (Saunders *et al*, 2003). Specifically, the study used a descriptive cross-sectional sample survey design as it is useful in giving insight into the general picture of the situation being investigated.

The study used the quantitative approach so as to benefit from the advantages inherent in quantitative designs. According to Kombo and Tromp (2006), the quantitative approach relies on the principle of verifiability, that is, confirmation, proof, corroboration or substantiation. It is applicable where the researcher incorporates the statistical element designed to quantify the extent to which the target group is (or thought or believed to be) aware of, or is inclined to behave in a certain way. It is also applicable when frequencies are required to explain meanings, thus necessitating the collection of numerical data in order to explain certain phenomenon. Finally, it is useful when data analysis is mainly statistical.

3.3 Target Population

A population is the whole group that the research focuses on (Kothari, 2012). It is the total number of subjects, or the total environment of interest of the researcher (Oso &

Onen, 2009). The total study population or the respondents was 100. The target population of this study was deposit taking financial institutions in Kenya comprising of the MFIs that had transformed into deposit taking institutions and those that were in the process of transforming in Kenya. In total there were 48 MFIs. Some of the MFIs had already been licensed by the CBK to undertake deposit taking microfinance business in Kenya while others were still in the process of transforming. The unit of observation for this study (the level at which data was collected) was individual while the unit of analysis (the level at which analysis and conclusions were done) was institutions.

The institutions were heterogeneous in terms of organizational nature and legal status (see Appendix 3). In terms of the organizational type, they ranged from financial services institutions (credit only), microfinance institutions, commercial bank, insurance company, wholesale microfinance institution, Non Government Organization, to microfinance programmes. They also varied in terms of their legal status because they were registered under different laws (Stevenson & St-Onge, 2005). These laws include the Microfinance Act, the Companies Act, the NGOs Coordination Act, the Harambee (Self-help) Group regulations, the Trustees Act and the Banking Act. The respondents were also heterogeneous in terms of age of their organization, legal status, type of organization, regional reach, number of clients, size of loan portfolio, value of capital, length of preparation period for transformation.

3.4 Sampling Frame

A sampling frame is the list of elements from which the sample may be drawn (Zikmund, 2010). It is also referred to as a working population because it provides the

list that a researcher can work with operationally (Kang'ethe, Karani, Elias, Mangera, & Pemba, 2008). The sampling frame for this study was the on-line register of AMFI members as at 1st January 2013. The register had 48 member institutions (AMFI, 2013).

3.5 Sample and Sampling Technique

This study used both purposive and simple random sampling to select the sample. Purposive sampling is a sampling technique that allows a researcher to use cases that have the required information in relation to the study objectives (Mugenda & Mugenda, 1999; Mutai, 2000; Kothari, 2004; Chandran, 2004; Oso & Onen, 2009). This technique was considered appropriate because the interest or scope of this study was with MFIs that were interested in transforming into regulated deposit taking financial institutions and had either started or completed the process. From this list, wholesale MFIs and all the institutions that were not microfinance institutions were eliminated. This left the study with 25 retail MFIs and microfinance banks. In this way, a total of 25 institutions were selected for this study.

The researcher was convinced that this method was appropriate because the AMFI Directory consisted of some institutions that were not MFIs or MFI banks (see Appendix 3). For instance some were listed because they provide insurance services to the MFIs while others were wholesale MFIs. These were outside the focus of this study.

The simple random sampling was then used to select four respondents comprising of managers and board members from each of the 25 sampled institutions. A simple

random sampling is a technique that allows the researcher to select a sample without bias from the target or accessible population (Mugenda & Mugenda, 1999; Mutai, 2000; Kothari, 2004; Chandran, 2004; Oso & Onen, 2009). In this way, a total of 100 respondents were selected to participate in the study.

3.6 Research Instrument

This study collected quantitative data on the challenges affecting transformation of microfinance institutions into deposit taking financial institutions using a questionnaire. A questionnaire is a collection of items or questions to which a respondent is expected to react or answer, usually in writing (Oso & Onen, 2009).

The questionnaire was "open ended" with an element of "Likert Scale" (see appendix 1). A questionnaire was chosen as the research instrument for this study because it is a suitable tool where the population is literate and the information needed can be easily described in writing (Oso & Onen, 2009). The population for this study was literate and the information required was of the nature that is easy to describe in writing. It was also chosen because questionnaires have a number of advantages. According to Kombo and Tromp (2006), as a research instrument, a questionnaire gathers data over a large sample. For instance data can be collected from a large sample and diverse regions and confidentiality is upheld. Using a questionnaire also saves time and, since they are usually presented in paper format, there is no opportunity for interviewer bias.

However, questionnaires have some disadvantages in that the response rate can be low. Because in many cases there is no direct contact, it is difficult for the researcher

to deal with misunderstanding. Likewise, there is no opportunity to seek clarifications or further information related to the answers given. To overcome these weaknesses, where practically possible, the researcher sat in as the respondent filled in the questionnaire and was, therefore able to clarify any issues.

3.7 Data Collection Procedure

This study collected quantitative data. Before going to the field, the researcher secured appointments with the respondents. Data was collected using a self-administered questionnaire (see appendix 1). The questionnaire was self-administered because all the respondents were literate, experienced and conversant with the issues surrounding the transformation of microfinance institutions (Mugenda & Mugenda, Kothari, 2004; Oso & Onen, 2009). Since the researcher was usually present as the respondent filled in the questionnaire, he promptly clarified any questions that were not very unclear to the respondent. Where it proved difficult for the respondents to complete the questionnaire immediately, the researcher left it with the respondents and told them when he would pick them up.

3.8 Pilot Testing

Pilot testing is the process of pre-testing the questionnaire with a small representative sample aimed at identifying potential misunderstandings or biasing effects of different questions and procedures (Kang'ethe *et al.*, 2008; Pallant (2007), and Nicol and Pexman (2010). The data collection instrument for this study was pre-tested using a small sample of deposit taking SACCOs but which were not included in the study sample. The pre-testing helped to point out questions that were difficult to understand, those that could be interpreted differently by different people, as well those that were

similar. After the pre-testing, improvements were made on the instruments and the final copies produced.

3.9 Data Analysis and Presentation

Data entry, storage and analysis were done with the aid of Scientific Package for Social Sciences (SPSS). After data collection, all the questionnaires were coded as part of the data cleaning process. The aim here was to eliminate unusable data. A coding scheme covering responses to all the questions was developed. The coding scheme facilitated the development of an appropriate data structure to enable its entry and storage in the computer, in readiness for its analysis. After all the data was entered into the computer, it was checked and corrected for any errors. After this editing the data was ready for analysis.

The data was first explored for the underlying factor structure among the study variables through factor analysis. Factor analysis was used because of the need to decompose the information contained in the set of variables into information about an inherent set of latent components/factors (Morgan & Griego, 1997; Pallant, 2007; Nicol & Pexman, 2010). This assisted in reducing the number of variables into fewer factors of similar characteristics. This was done using Principal Component Analysis (PCA). After that, the extracted variables were explored in terms of descriptive statistics and logistic regression.

Inferential statistical analysis was then used to test for the existence of relationships between the variables rather than the effect of one variable on another. This was because the respondents were heterogeneous in such features of the organization as

age, legal status, and type of organization, number of clients, size of loan portfolio, and number of branches, lending methods, and products. To achieve this, data was analyzed using Pearson Chi-square, which shows the degree of relationship between categorical variables (Kombo & Tromp, 2006; Cooper & Schindler, 2008).

In addition, the study used direct logistic regression to assess the impact of a number of factors (continuous independent variables) on the likelihood that they would report successful transformation (dichotomous dependent variable). According to Morgan and Griego (1997), Pallant (2007), and Nicol and Pexman (2010), logistic regression is the appropriate technique to test models that seek to predict the categorical outcomes where the dependent variable is dichotomous. The dichotomous dependent variable for this study was transformation status, with the outcomes being classified as either 0 (“without a license”) or 1 (“with license”).

The general logistic regression equation is:

$$\text{Logit } P(X) = a + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \ldots + \beta_n X_n + e$$

Where,

a is a constant

$\beta_1, \beta_2, \beta_3, \beta_4 \ldots$ and β_n are regression coefficients

$X_1, X_2, X_3, X_4 \ldots$ and X_n are independent variables

e is error term

This model was applied for each of the independent variables to test for the goodness of fit with the dependent variable.

To test a hypothesis means to establish whether or not the hypothesis seems to be valid on the basis of the data the researcher collected (Kothari, 2012). The purpose of hypothesis testing is to determine the accuracy of the study hypotheses due to the fact that the researcher has collected a sample of data and not a census. The four null hypotheses were tested using chi-square.

The chi-square test can be used to determine whether an independent variable is a factor influencing the dependent variable or not (Aggarwal, 1991; Mugenda & Mugenda, 1999). This test was carried out for each of the independent variables over the dependent variable. The model was fitted on the basis of the explanatory variables determined by inferential statistics. The hypotheses were tested at 95% confidence level.

CHAPTER FOUR

RESEARCH FINDINGS AND DISCUSSION

4.1 Introduction

This chapter contains the presentation and discussion of the findings of this study. The main objective of the study was to establish the challenges that affect transformation of microfinance institutions into deposit taking financial institutions in Kenya with an aim to recommending a blueprint for MFI transformation in Kenya. The study was guided by a conceptual framework which comprised of four independent variables and one dependent variable. The independent variables were planning for transformation, legal compliance, management of stakeholders, and institutional change management. The dependent variable was MFI transformation status.

4.2 Questionnaire Return Rate

The study targeted all the 48 institutions that were members of AMFI by 1st January 2013 (see Appendix 3). From the target population, a sample of 25 retail MFIs and microfinance banks was drawn. From each of the 25 institutions, the study randomly selected four respondents. As such, questionnaires were distributed to a total of 100 respondents. The results on the questionnaire return rate are presented in Table 4.1.

Table 4.1: Questionnaire Return Rate

Participants	Questionnaires issued	Questionnaires returned	Percentage returned
Individual respondents	100	60	60
Institutions involved	25	18	72

Sixty questionnaires were returned by respondents from 18 out of the 25 institutions sampled by the study. This represented an overall response rate of 60 % of individual respondents and 72% of institutions involved in the study. Babbie (2002) observes that in descriptive research, a response rate of above 50% is adequate for analysis. The response for this study was, therefore, considered adequate and was attributed to the largely face to face administration of the questionnaires. It was also consistent with the expected return rate of about 75% for face to face administered questionnaires (Saunders, Lewis & Thornhill, 2007).

4.3 Profile of Surveyed Institutions

4.3.1 Period of Operating Microfinance in Kenya

As part of the background information on the MFIs, the respondents were asked to state the year when their institutions started microfinance operations in Kenya. This question was intended to determine the period over which the institutions had ran microfinance operations in Kenya and to establish whether the period of operation in Kenya was a determinant in the transformation status. The results are presented in Table 4.2.

Table 4.2: Period of Microfinance Operations in Kenya and Transformation Status

Period of Operation	Percentage no. transformed	Percentage no. not transformed	Total
5 years and below	18.3	30	48
6 to 10 years	0	11.7	11.7
11 years and above	20	20	40
Total	38.3	61.7	100

n = 60
$\chi^2 = 5.735$; df = 2; Asymp. Sig. (2-sided) = 0.57

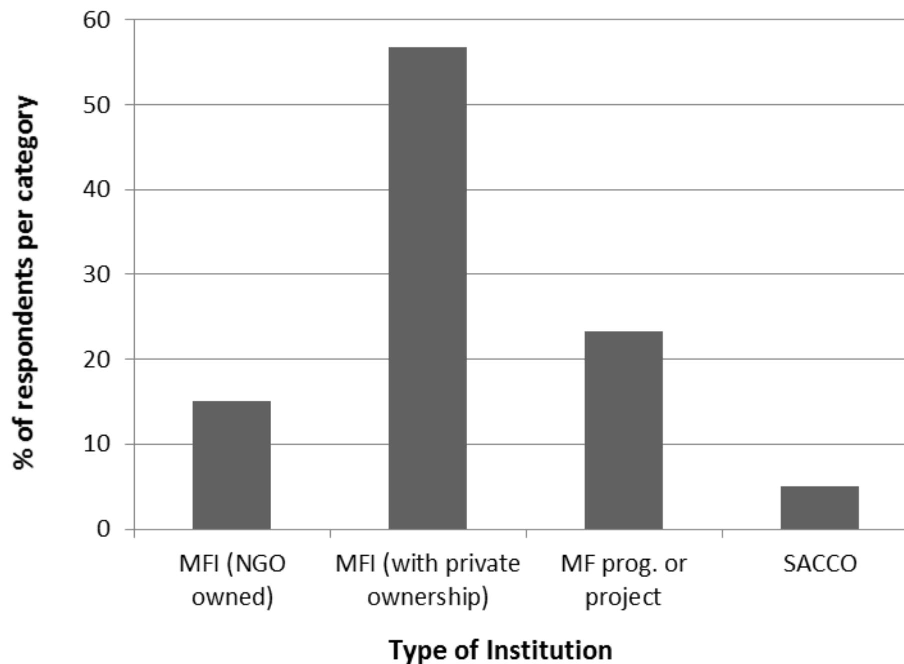
The majority of the respondents (48%) stated that their institutions had undertaken microfinance operations in Kenya for 5 years and below (see Table 4.2). Only 11.7% stated that their institutions had operated for 6 to 10 years. Some of the institutions that had operated for 11 years and above in Kenya are SISDO, Equity Bank, KWFT, SMEP, Jamii Bora and KADET. In total, 51.7% of the respondents indicated that their organizations had operated microfinance in Kenya for more than five years. Thirty eight percent of the firms indicated transformed status, a proportion lower than 61.7% that indicated not transformed status.

The findings indicate that the majority of the MFIs had operated for an adequate period of time, thereby gaining the necessary experience to enable them move into the growth phase. It is during the growth phase that MFIs start finding it difficult to fully meet their clients' expectations in terms of demands for loans and a variety of non-credit financial services like savings facilities and capacity building. This also indicates that the MFIs that participated in the study had adequate experience in microfinance operations in Kenya and thus understood the issues under research.

Further analysis was conducted using Pearson's Chi-square to establish whether the period of microfinance operation in Kenya was a determinant in the overall success of an institution's transformation effort. It was found that there was no significant difference between the findings from MFIs that had operated for 5 years and below, 6 to 10 years and 11 years and above (*P*=0.057; n=60) as shown in Table 4.2. This means that the period of microfinance operation in Kenya was not a significant determinant in the transformation status of MFIs in Kenya. This is attributed to the fact that transformation is indicated by the issuance of a deposit taking license and this process is largely dependent upon meeting all the requirements of the Central Bank of Kenya. These requirements apply across all MFIs regardless of the period that they had operated as microfinance institutions in Kenya.

4.3.2 Type of Institution Before Seeking to Transform

The participants were asked what the type of their institution was before seeking to transform. The results are presented in Figure 4.1.



n=60

Figure 4.1: Type of Institution Before Seeking to Transform

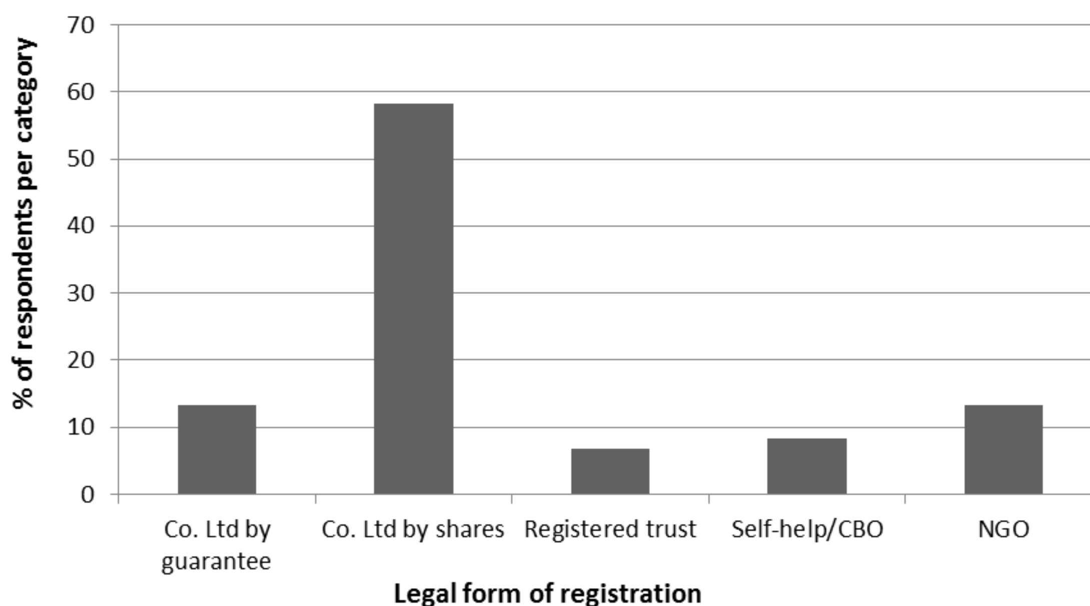
The findings show that the majority of the respondents (56.7%) were from MFIs in Kenya that had operated as microfinance institutions with private ownership before seeking to transform (see Figure 4.1). The least proportion of the respondents (5%) indicated that their organizations had operated as SACCOs in Kenya. There was a very small percentage of SACCOs because most of the SACCOs that wish to transform into deposit taking financial institutions in Kenya do so under the SACCO Societies Act. In addition, most of them are not members of AMFI.

The finding that the majority of the institutions were microfinance institutions with private ownership was attributed to the fact that over time, many MFIs had started incorporating private ownership in anticipation of transformation. In addition, some of

the MFIs had been set up as private entities right from the beginning. Institutions that had private ownership include Platinum Credit, Blue Financial, Rafiki, SMEP, REMU, and UWEZO. This is consistent with the findings on the legal form of registration presented in Figure 4.2 which show that most of the institutions in Kenya (58.3%) were registered as company limited by shares.

4.3.3 Legal Form of Registration Before Seeking Transformation

The study also sought to find out the legal form under which the institutions were registered before seeking to transform. The findings are presented in Figure 4.2.



n = 60

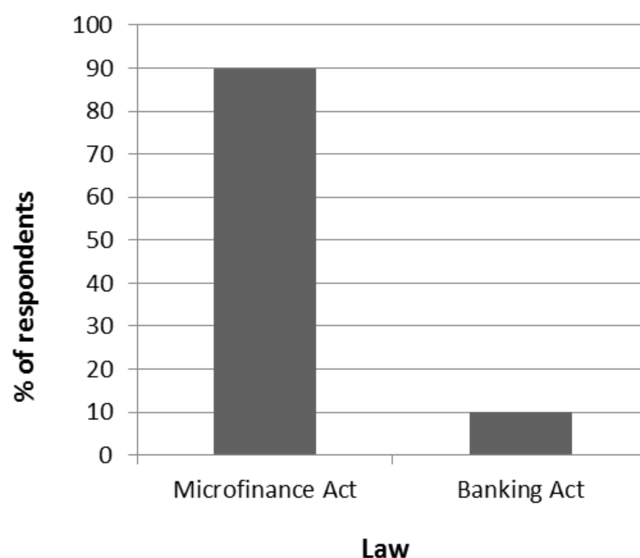
Figure 4.2: Legal Form of Registration Before Seeking to Transform

The findings were that most of the institutions in Kenya (58.3%) were registered as company limited by shares as shown in Figure 4.2. The least frequent legal form of registration was self-help/community based organizations (CBOs) (8.3%) and trusts (6.7%). The finding that a very small proportion of MFIs in Kenya had been

registered as CBOs and trusts may be explained by the fact that transformation requires enormous resources (Frankfurt School of Finance & Management, 2012) and small organizations like CBOs may not have adequate resources to transform. Besides, most CBOs and Trusts are not registered with AMFI as members. In addition, most CBOs and Trusts are member-serving. This means that they provide their services to their own members rather that reaching out to the general members of the public. As such, most of them may not have any intention to become deposit taking financial institutions.

4.3.4 Law Under Which Transformation was Sought

The study sought to find out the legal framework under which the MFIs had sought to transform. The findings are presented in Figure 4.3.



n=60

Figure 4.3: Law Under Which Transformation was Sought

The majority of the respondents (90%) stated that their MFIs sought to transform under the microfinance act of 2006 while only 10% indicated that their organizations had sought to transform under the banking act in Kenya (see Figure 4.3). This is consistent with the overall aim of the study which was to determine the challenges affecting transformation of MFIs into deposit taking financial institutions in Kenya under the microfinance act. In addition, most of the members of AMFI are MFIs with a few banks that had started off as microfinance organizations. Institutions that sought to or transformed under the banking act are Equity Building Society and Jamii Bora Microfinance which transformed into Equity bank and Jamii Bora bank respectively. All the other institutions sought to transform under the microfinance act of 2006.

4.3.5 Current Number of Operational Branches

The respondents were asked to state the number of operational branches that their MFIs had currently. The findings are presented in Table 4.3.

Table 4.3: Number of Operational Branches and Transformation Status

Number of branches	Percentage no. transformed	Percentage no. not transformed	Total
1 to 10	18.3	43.3	61.7
11 to 20	8.3	13.3	21.7
Over 20	11.7	5.0	16.7
Total	38.3	61.6	100

n = 60
χ^2 = 5.401; df = 2; Asymp. Sig. (2-sided) = 0.067

The findings show that the majority of the respondents (61.7%) indicated that their organizations had 1 to 10 branches while the least proportion (16.7%) indicated that

their organizations had over 20 branches in Kenya (see Table 4.3). MFIs that had over 20 branches include Equity bank (120 branches), Jamii Bora (over 80 branches), KWFT (35 branches) and Platinum Credit (24). This shows that the MFIs were fairly mature since takes time before an MFI can open additional branches. This also partially explains the fact that they had sought to transform. The findings also show that 38% of the respondents indicated transformed status, a proportion lower than 61.7% that indicated not transformed status. MFIs that had transformed include Equity bank, KWFT, SMEP, and Jamii Bora.

Further analysis was conducted using Pearson's Chi-square to establish whether the number of operational branches that an MFI had was a determinant in the overall success of the institution's transformation effort. It was found that there was no significant difference between MFIs that had 1 to 10 branches, 11 to 20 branches and those with over 20 branches (P=0.067; n=60) as shown in Table 4.3. This means that the number of operational branches in Kenya was not a significant determinant in the transformation status of MFIs in Kenya. This can be attributed to the fact that a transforming MFI needs to expand its operations, which in turn requires an expansion of the area of coverage and associated facilities. As part of their transformation plans, many MFIs start increasing the number of branches as soon as they get board and management approval (Frankfurt School of Finance & Management, 2012). In addition, the law and regulations allow a transforming MFI to operate within a small area if it so wishes, rather than operating nationally.

4.3.6 Number of Active Clients Served

In order to establish the size of the MFIs in terms of client portfolio, the respondents were asked to state the number of active clients that they had. The findings are presented in the Table 4.4.

Table 4.4: Number of Active Clients and Transformation Status

Number of clients	Percentage no. transformed	Percentage no. not transformed	Total
1 - 500,000	39.3	33.9	73.2
500,001 - 1,000,000	0	16.1	16.1
Over 1,000,000	1.8	8.9	10.7
Total	41.1	58.9	100

n=56

χ^2 = 10.433; df = 2; Asymp. Sig. (2-sided) = 0.005

The findings show that a total of 56 respondents answered this question, the majority (73.2%) of whom indicated that their institutions had 1 – 500,000 active clients while the smallest proportion (10.7%) indicated that their institutions had over 1 million active clients (see Table 4.4). The results further show that 41.1% of the firms that responded to this indicated that there was successful transformation, a proportion lower than 58.9% that indicated that transformation was not successful. MFIs that had 1 – 500,000 active clients include SISDO, KWFT, Blue Finance, Rafiki, SMEP, Jamii Bora and KADET. Those that had 500,001 – 1,000,000 active clients include Micro Africa, Greenland and Canyon Rural Credit. Those that had over 1,000,000 active clients include Equity bank, Platinum Credit and Opportunity Kenya. The small proportion of MFIs with over 1 million active clients is attributed to the fact that it is difficult to meet the needs of such numbers before transformation into a DTM.

Indeed, it is out of the need to develop the capacity to serve such large numbers of clients sustainably that MFIs seek transformation (Christen *et al.*, 2004).

Further analysis was conducted Pearson's Chi-square to establish whether the number of active clients that an MFI had was a determinant in the overall status of an institution's transformation effort. It was found that there was a significant difference between MFIs that had 1 - 500,000 active clients, 500,001 - 1,000,000 active clients and those with over 1,000,000 active clients (P=0.005; n=56) as shown in Table 8. This means that the number of active clients was a significant determinant in the transformation status of MFIs in Kenya. This is because one of the reasons for MFI transformation is to meet the needs of the growing number of clients (Frankfurt School of Finance & Management, 2012).

4.3.7 Size of Current Loan Portfolio

Respondents were asked to state the size of their current loan portfolio. Loan portfolio is the total amount of the outstanding loan balance. The findings are presented in Table 4.5.

Table 4.5: Size of Current Loan Portfolio and Transformation Status

Portfolio (Kshs)	Percentage no. transformed	Percentage no. not transformed	Total
1 to 500 million	19.2	28.8	48
500,000,001 to 1 billion	13.5	15.4	28.9
Over 1 billion	11.5	11.5	23
Total	44.2	55.8	100

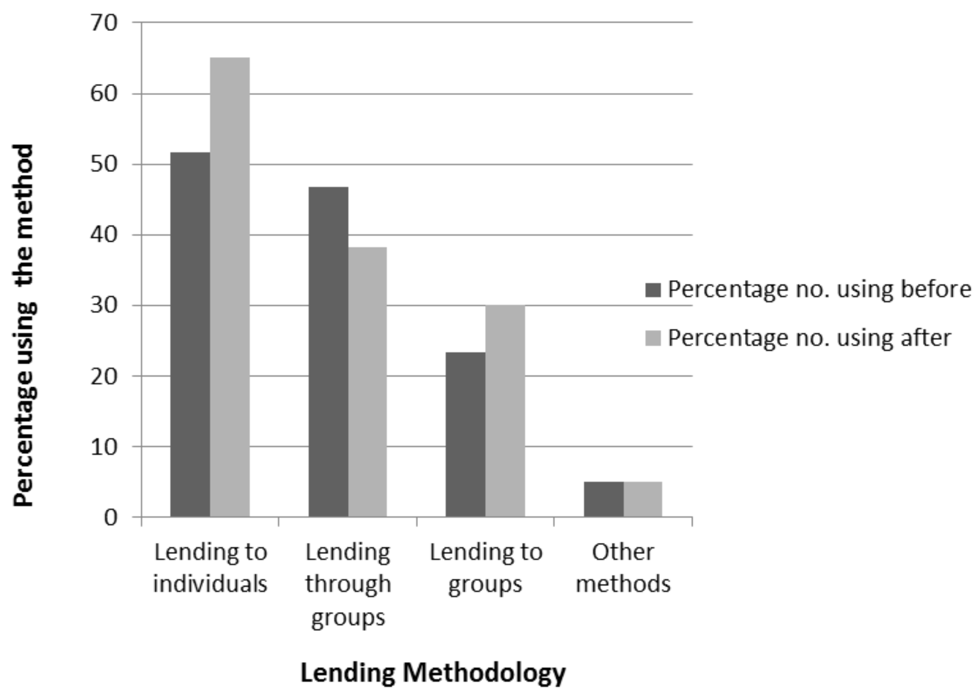
n= 52
χ^2 = 0.379; df = 2; Asymp. Sig. (2-sided) = 0.827

The findings show that 48.1% of the 52 who responded to this question indicated that their organizations had a loan portfolio ranging from 1 to 500 million Kenya shillings. The least proportion of respondents (23.1%) reported that their organizations had a loan portfolio of over 1 billion Kenya shillings. Organizations that reported a loan portfolio of over 1 billion Kenya Shillings include Platinum and Jamii Bora. Those that reported a portfolio of 1 to 500 million Kenya shillings include Rafiki, KADET, Canyon Rural Credit and REMU. The findings further show that 44.2% of those who responded to this question reported transformed status, a proportion lower than 55.8% who reported not transformed status. The percentage of successful transformation reduces as the loan portfolio increases. Likewise, the percentage of unsuccessful transformation also reduces as the loan portfolio increases. This suggests that there is a relationship between the loan portfolio and transformation status.

Further analysis was thus conducted using Pearson's Chi-square to establish whether the size of an MFI loan portfolio was a determinant in the overall success of an institution's transformation effort. It was found that there was no significant difference between MFIs that had Kshs1 to 500m, those with Ksh. 500,000,001 to 1 billion and those with over Ksh. 1 billion loan portfolio (P=0.827; n=52) as shown in Table 4.5. This means that the size of an MFI loan portfolio was not a significant determinant in the successful transformation of an MFI in Kenya. This disproves the findings from descriptive statistics.

4.3.8 Lending Methodologies Before and After Seeking Transformation

As part of the background information, respondents were asked to state the lending methodologies that their institutions used before and after seeking to transform in Kenya. This was intended to establish whether transformations led to changes in the lending methods used. The findings are presented in Figure 4.4.



n=60

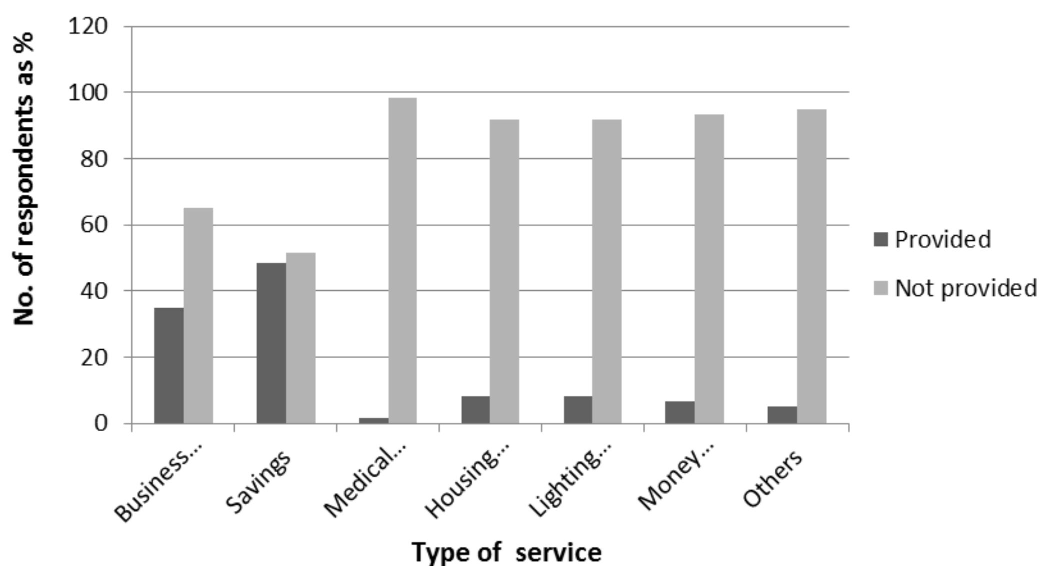
Figure 4.4: Lending Methodologies Used Before and After Transformation

The findings show that the most commonly used lending method was individual based (51.7% before and 65% after transformation) in Kenya (see Figure 4.4). The least used method was lending to groups (23.3% before and 30% after transformation). The findings also indicate an increase in usage of those two methods after seeking to transform. This is consistent with the need to increase the breadth of outreach (providing access to as many people as possible) and depth of outreach (reaching as far down the income scale as practically possible) after transformation (Christen *et al.*,

2004). Lending to group members only tends to result in a smaller average loan per client, accompanied by high transaction costs. To be sustainable, regulated MFIs introduce individual lending to cut down on transaction costs and thus remain profitable. However, to avoid a mission drift, many such MFIs try to maintain a mix of individual and group based lending (Frankfurt School of Finance & Management, 2012).

4.3.9 Financial Services Other Than Credit (Loans) Being Offered

The respondents were also asked to state any other financial services other than credit (loan) that their MFIs offer. The non-credit financial services mentioned by the respondents are business training, savings, medical insurance, housing, lighting, and money transfer services. The findings are presented in Figure 4.5.



n=60

Figure 4.5: Non-credit Financial Services Provided

The most popular non-credit financial service was savings as indicated by the biggest proportion of respondents (51.7%) as shown in Figure 4.5. The least mentioned service is medical insurance (1.7%). This is consistent with transformations as their major objective is to mobilize deposits from the public. Savings (deposit taking) is regulated and is only possible for MFIs that are licensed as deposit-taking institutions such as DTM MFIs, Banks, or SACCO societies.

4.3.10 Reasons For Transformation

The respondents were asked to rank the five most commonly cited reasons for MFI transformation according to the priority that their organization placed on each of the reasons. The five reasons are: to access to additional sources of funds to support growth profitability and sustainability; to offer a wider range of financial services and products; to improve efficiency and overall financial performance; to meet competition and to improve customer satisfaction. The findings are presented in Table 4.6.

Table 4.6: Ranking of the Reasons for Transformation

Reason	Percentage ranking of priority by respondents						
	1	2	3	4	5	6	Total
To access additional sources of funds	35.1	7	24.6	21.1	12.3	-	100
To offer a wider range of services and products	15.8	29.8	29.8	21.1	3.5	-	100
To improve efficiency and overall financial performance	14	38.6	15.8	26.3	5.3	-	100
To meet competition	5.3	14	19.3	22.8	38.6	-	100
To improve customer satisfaction	40.4	26.3	21.1	7	1.8	3.5	100

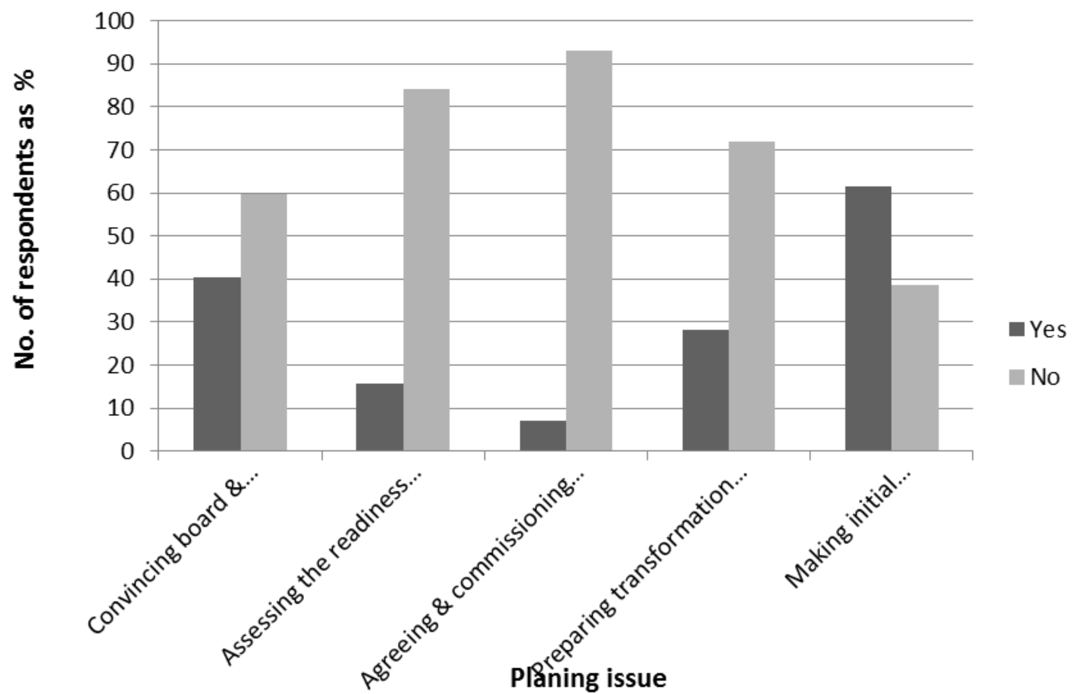
n = 57

Key: Rank 1 represents the highest or top priority while rank 6 represents the lowest priority.

The most popular reason for transformation was to improve customer satisfaction (ranked as priority number 1 by 40.4% of the respondents) in Kenya as shown by the findings in Table 4.6. The least popular is to meet competition (ranked as priority number 5 by 38.6% of the respondents). Besides the ranking, the results confirm the five reasons for MFI transformation in Kenya. For instance, Faulu and KWFT indicated the five as their reasons for transformation (Frankfurt School of Finance & Management, 2012). These findings are consistent with other research findings on the objectives of transformation in Kenya and elsewhere (Christen & Rosenberg, 2003; Mutahi, 2008; Frankfurt School of Finance & Management, 2012).

4.4 Planning as a Challenge in the Transformation of MFIs into Deposit Taking Financial Institutions in Kenya

The first specific objective of this study was to establish to what extent planning is a challenge in the transformation of microfinance institutions into deposit taking institutions in Kenya. Planning for transformation was conceptualized to be measured using five items. The five items for measuring planning for transformation were convincing the board and management on the need to transform, assessing the readiness for transformation, agreeing and commissioning a transformation manager, preparing the transformation plan, and making initial consultations with the regulator, that is the CBK. The respondents were asked to indicate whether or not they had experienced challenges with those activities when preparing for transformation in Kenya. The findings are presented in Figure 4.6.



n = 57

Figure 4.6: Whether Planning was a Challenge

The most frequently mentioned challenge at the phase of planning for transformation was making initial consultations with the central bank (61.4%) in Kenya as shown in Figure 4.6. The least mentioned challenge was agreeing on and commissioning a transformation manager or team (7%). This can be attributed to the fact that making consultations with the CBK is a process that is largely outside the control of MFIs. This is unlike agreeing and commissioning a transformation manager which is a process that is within the control of an MFI. For instance, FAULU settled on the Internal Audit Manager as the transformation manager (Frankfurt School of Finance & Management, 2012). This was intended to ensure that the transformation manager was familiar with the company and to provide guidance on the needs of the organization and proper co-ordination of the process.

Each of the five items in the scale for measuring planning for transformation was subjected to further analysis in order to test null hypothesis 1 which was in respect of the first independent variable, namely, planning. The hypothesis was stated as follows:

H_{01} There is no significant effect of planning on the transformation of microfinance institutions into deposit taking financial institutions in Kenya.

The Chi-square test for independence was used because it is the appropriate test where both the dependent and independent variables are categorical (Morgan & Griego, 1997; Pallant, 2007; Nicol & Pexman, 2010). The dependent variable and the five independent variables (factors) for this study were categorical. The results are presented in Table 4.7.

Table 4.7: Chi-Square Test for Independence for Planning Variable Items

Item	χ^2	df	Asymp. Sig. (2-sided)
Convincing the board and management on the need to transform	11.946	1	0.001
Assessing the readiness for transformation	0.219	1	0.640
Agreeing and commissioning a transformation manager	0.421	1	0.516
Preparing the transformation plan	2.336	1	0.126
Making initial consultations with CBK	0.005	1	0.946

n = 57

Key:
Criteria for determining the overall significance of planning as a challenge:

- Overall, the Independent Variable (Planning) was considered significant if the Chi-square test for independence for more than 50% of the items in the scale was significant.

The Chi-square test for independence indicated a significant association between convincing the board and management on the need to transform and successful transformation status, χ^2 (1, n = 57) = 11.946, P = 0.001 (see Table 4.7). This means that the difficulty faced in getting board and management approval was a significant determinant in the successful transformation of an MFI in Kenya. This indicates that the more difficult it is to convince the board and management on the need to transform, the more difficult it will be to succeed in transformation. If the board and management are not enthusiastic at the very first step, it is highly unlikely that they will give their support in subsequent steps. The effect is that it will be difficult for such an MFI to succeed in transforming.

For each of the other four items, the test results were not significant. The item with the least association with successful MFI transformation status in Kenya was making initial consultations with CBK. The Chi-square test for independence indicated no significant association between difficulty of initial consultations with CBK and successful transformation status, χ^2 (1, n = 57) = 0.005, P = 0.946 as shown in Table 8. This means that the difficulty (or ease) of making initial consultations with CBK was not a significant determinant in the successful transformation of an MFI in Kenya. This may be attributed to the fact that this process is largely outside the control of MFIs and whose success is largely affected by government bureaucracy (Campion & White, 1999).

The above findings mean that that the study established a significant association between successful MFI transformation status in Kenya and only 1 out of the 5 planning items (20%). Based on the above findings, the null hypothesis (H_{01}) that

there is no significant effect of planning on the transformation of microfinance institutions into deposit taking financial institutions in Kenya was accepted. The study thus concluded that planning for transformation was not a significant challenge affecting the transformation of microfinance institutions into deposit taking financial institutions in Kenya.

4.5 Legal Compliance as a Challenge in the Transformation of MFIs into Deposit Taking Institutions in Kenya

The second objective of this study was to determine whether legal compliance is a challenge affecting transformation of microfinance institutions into deposit taking financial institutions in Kenya. The respondents were asked to indicate the level of difficulty with complying with the legal requirements. Specifically, they were asked to indicate the level of difficulty in complying with various requirements before an MFI can be issued with a license to operate as a deposit taking financial institution in Kenya. The responses were measured on a four point likert scale of 1 to 4 with 1 as 'very low', 2 as 'low', 3 as 'high', and 4 as 'very high' level of difficulty. Descriptive statistics were calculated and the results are presented in Table 4.8.

Table 4.8: Descriptive Statistics for Level of Difficulty with Legal Compliance

Item	N	Mean
Name Search - Registrar of Business Names	59	1.97
Name approval by CBK	50	2.28
Application form and support documents	51	2.82
Providing Evidence of Capital	51	1.98
Submitting Feasibility Study and Business Plan	47	2.30
Fit and Proper forms – Individual	47	2.83
Fit and Proper forms - Corporate	44	2.66
Other Requirements Local Applicants	43	3.05
Meeting Other requirements - Foreign Subsidiaries	38	1.53
Getting Letter of Intent and Final Steps	41	2.37
Getting Issued with License	40	3.05

Key:
Mean of 1.00 – 2.44: Low level of difficulty
Mean of 2.45 – 4.00: High level of difficulty

The findings show that two steps in the licensing process in Kenya presented the highest level of difficulty (3.05) (see Table 4.8). These were meeting other requirements for local applicants and issuance of license while the step with the least level of difficulty was meeting other requirements for foreign subsidiaries (1.53). Getting issued with a license had the highest level of difficulty the step is outside the control of MFIs. Even after an MFI meets all the requirements, it has to wait for the CBK to issue it with the license. The latter is subject to government bureaucracy which can seriously slow down the transformation process. Likewise, before getting the license, an MFI cannot start operations.

The findings were further subjected to factor and regression analysis. Factor analysis was used so as to decompose the information contained in a set of variables into information about an inherent set of latent components or factors. This assisted in reducing a number of variables into fewer factors which are of similar characteristics and isolate factors with main effects to the characteristics of the dependent variable (transformation status of the MFI).

The correlation matrix of the factors making up the legal compliance variable revealed that there were 21 factors at 95% and 99% confidence interval with correlation coefficients of 0.3 and above (see Appendix 5). Thus the data for these variables was considered suitable for factor analysis.

Further extraction revealed a total of four factors with eigenvalues of 1 and above and these accounted for 74.6% of the variance. Through Principal Component Analysis (PCA) method, four factors were extracted. These are presented in Table 4.9.

Table 4.9: Structure Matrix and Means for Legal Compliance Components

	Component			
	1	2	3	4
Submitting Feasibility Study and Business Plan	.880			
Name Search - Registrar of Business Names	.808	.325		
Providing Evidence of Capital	.721	-.354		-.345
Meeting Other requirements - Foreign Subsidiaries	.687	-.456		-.431
Application Form		.736		.308
Name Approval		.722		
Getting Issued with License			.936	
Getting Letter of Intent and Final Steps			.798	-.469
Other Requirements Local Applicants		.315		.890
Fit And Proper forms for Individual	-.450			.799
Fit And Proper forms for Corporates		.646		.727
Means	1.99	2.54	2.73	2.85

Key:

- Variable Extraction Method: Principal Component Analysis; Rotation Method: Oblimin with Kaiser Normalization.
- Criteria for factor analysis: loading of 0.5 and above on a component was accepted.
- The factor “fit and proper forms for corporate” loads strongly on components 2 and 4. However, it conceptually fits more with the other factors in component 4. It was thus analysed as part of component 4.
- Mean of 1.00 - 2.44: Low level of difficulty; Mean of 2.45 – 4.00: High level of difficulty

The resultant four components were renamed as: component 1 (incorporation of business), component 2 (application for license and documentation), component 3 (issuance of license), and component 4 (fit and proper test). Component 1 (incorporation of business) comprised of four variables. These were submitting feasibility study and business plan, name search - registrar of business names, providing evidence of capital and meeting other requirements for foreign subsidiaries. Component 2 (application for license and documentation) comprised of two variables. These were application form and support documents and name approval by the central bank. Component 3 (issuance of license) comprised of two variables. These were getting issued with license and getting letter of intent and final steps. Component 4 (fit and proper test) comprised of three variables. These were meeting other requirements for local applicants, submitting "fit and proper forms" for individual shareholders, and submitting "fit and proper forms" for corporate shareholders.

The means for the re-named factors were calculated using the average scores for each factor and the results are presented in Table 4.9. The findings show that only one factor (incorporation) of business had a low level of difficulty (1.99). All the other factors had high level of difficulty with fit & proper test having the highest level of difficulty (2.85). This may be explained by the fact that incorporation of business is a process that involves the MFI and the registrar of companies rather than the CBK. All the other factors involve dealing with the CBK, within the guidelines issued by CBK under the Microfinance Act 2006.

Direct logistic regression was performed to assess the impact of a number of factors on the likelihood that respondents would report that they had transformed. The null hypothesis was stated as follows:

H_{02} *There is no significant effect of legal compliance on the transformation of microfinance institutions into deposit taking financial institutions in Kenya.*

Direct logistic regression was chosen because it is the appropriate technique where the dependent variable is dichotomous or categorical (Morgan & Griego, 1997; Pallant, 2007; Nicol & Pexman, 2010). In this study, the dependent variable (transformation status) was categorical (transformed / not transformed). The model contained four factors, namely, incorporation of business, application for license and documentation, issuance of license, and fit and proper test. The model was fitted as:

Logit (Transformation status) = 0.171 + 0.01(incorporation of business) + 0.38(application for license and documentation) + 0.50(issuance of license) + 0.484(fit and proper test)

The full results are presented in Table 4.10.

Table 4.10: Logistic Regression Predicting Likelihood of Reporting Transformation from Legal Compliance Factors

Component	df	Sig.	Exp(B) (Odds Ratio)
Incorporation of business	1	0.01	0.13
Application for License & Documentation	1	0.38	2.43
Issuance of License	1	0.50	0.64
Fit & Proper Test	1	0.484	0.488
Constant	1	0.171	189.180

n = 38
χ^2 = 12.862; df = 4; Sig. = 0.012.

Cox and Snell R square (0.287); Nagelkerke R square (0.384).

Overall percentage correct prediction (68.4%)

The full model containing all predictors was statistically significant, χ^2 (4, *N*=38) = 12.862, *P*=0.012 indicating that the model was able to distinguish between respondents who reported and did not report successful transformation in Kenya as shown in Table 11. The model as whole explained between 28.7% (Cox and Snell R square) and 38.4% (Nagelkerke R square) of the variance in transformation status, and correctly classified 68.4% of cases. Only one of the independent variables (incorporation of business) made a unique statistically significant contribution to the model. The strongest predictor of reporting successful transformation was application for license and supporting documentation, recording an odds ratio of 2.43. This indicates that respondents who had difficulty with application for license and supporting documentation were 2.4 times less likely to report successful transformation than those who did not have a difficulty with application for license and supporting documentation, controlling for all other factors in the model. Therefore, the null hypothesis (H_{02}) that *there is no significant effect of legal compliance on the transformation of microfinance institutions into deposit taking financial institutions in Kenya* was rejected.

The above findings are consistent with the findings of the case studies on the transformation of K-Rep, KWFT, and Faulu (Rosenngard *et al.*, 2000; Frankfurt School of Finance and Management, 2012). The case studies showed that compliance with CBK regulations is both time and resource consuming which narrows the chances of effective institutional transformation. As such, whereas nearly 15 institutions were expected to transform within two years, starting from the implementation of the Act, by the end of 2010 only three had successfully completed the process and been granted a deposit-taking license. Faulu Kenya DTM Limited was licensed in May 2009, Kenya Women Finance Trust DTM Limited in April 2010, and Uwezo DTM Limited as a Community DTM in November 2010. Nevertheless, over 30 more institutions had passed the initial stage of approval by the end of 2009 (approval of business name).

When applying for a license, an MFI is required to provide various supporting documents, duly certified as true copies of the original by a commissioner of oaths or public notary (CBK, 2008). The documents to be attached include Certificate of Incorporation, Tax Personal Identification Number (PIN) Certificate, Registered Memorandum and Articles of Association indicating the core capital, verified Official Notification of Company's Registered Place of Business and the prospective places of business (head office and, branches, agency and outlets, if any). One should also attach payment (banker's cheque) for the appropriate non-refundable application fee. It, therefore, follows that if an MFI has difficulties providing the above supporting documents, it will most likely not report successful transformation.

4.6 Management of Stakeholders as a Challenge in the Transformation of MFIs into Regulated Deposit Taking Institutions in Kenya

The third objective of this study was to determine whether management of stakeholders was a significant challenge in the transformation of microfinance institutions into deposit taking institutions in Kenya. The issues of managing stakeholders that have been reported to have presented challenges to transforming MFIs in other countries are guarding against mission drift, attracting private owners, creating an appropriate governance structure (BOD), transfer of assets to the new RFI, transfer of liabilities to the new RFI, handling staff concerns, and handling client concerns.

The respondents were asked to indicate the level of difficulty with complying with managing stakeholders. Specifically, they were asked to indicate the level of difficulty in complying with various aspects of managing stakeholders. The responses were measured on a four point likert scale of 1 to 4 with 1 as 'very low', 2 as 'low', 3 as 'high' and 4 as 'very high' level of difficulty. Descriptive statistics were calculated and the results are shown in Table 4.11.

Table 4.11: Descriptive Statistics for Level of Difficulty with Managing Stakeholders

	N	Mean
Guarding Against Mission Drift	53	2.26
Attracting Private Owners	53	2.25
Creating Governance Structure (BOD)	50	2.10
Transfer of Assets to new RFI	47	2.38
Transfer of Liabilities to new RFI	47	2.53
Handling Staff Concerns	50	2.20
Handling Client Concerns	50	2.18

Key:
Mean of 1.00 - 2.44: Low level of difficulty
Mean of 2.45 – 4.00: High level of difficulty

The findings show that only one factor (transfer of liabilities to the new RFI) had a high level of difficulty (2.53) in Kenya (see Table 4.11). All the other factors had a low level of difficulty with creating governance structure having lowest level of difficulty (2.10). This suggests transfer of liabilities to the new RFI to be a key challenge with regard to the management of stakeholders. The difficulty might arise from the resistance of lenders to being transferred to the new RFI. As Lauer (2008) argues, few creditors will want to be left in a situation where they can only recover from the NGO, yet the NGO will have transferred its loan portfolio - the principal source and guarantee of repayment - to another entity.

The findings were further subjected to factor and regression analysis. Factor analysis was used so as to decomposee the information contained in a set of variables into information about an inherent set of latent components or factors. This assisted in reducing a number of variables into fewer factors which are of similar characteristics and isolate factors with main effects to the characteristics of the dependent variable (successful transformation of MFIs).

The correlation matrix of the factors making up the management of stakeholders variable revealed that there were five factors at 95% and 99% confidence interval with correlation coefficients of 0.3 and above (see Appendix 6). Thus the data for these variables was considered suitable for factor analysis. In the resulting Total Variance Explained table, a total of three factors, each with eigenvalues of 1 and above were extracted. Together, these three factors accounted for 66.89% of the variance.

Consequently, through Principal Component Analysis (PCA) method, three factors were extracted. The structure matrix of the three factors and their loadings is presented in Table 4.12.

Table 4.12: Structure Matrix and Means for Managing Stakeholders Components

	Component		
	1	2	3
Handling Client Concerns	.891		
Handling Staff Concerns	.859		.386
Guarding Against Mission Drift		.843	
Transfer of Liabilities to New RFI		.688	
Creating Governance Structure(BOD)		.512	
Transfer of Assets to new RFI		-.351	.846
Attracting Private Owners	.388		.795
Means	2.19	2.33	2.28

Key:

- Variable Extraction Method: Principal Component Analysis; Rotation Method: Oblimin with Kaiser Normalization.
- Criteria for factor analysis: loading of 0.5 and above on a component was accepted.
- Mean of 1.00 - 2.44: Low level of difficulty; Mean of 2.45 – 4.00: High level of difficulty.

The resultant three components were renamed as: component 1 (managing staff and clients), component 2 (creating appropriate governance structures), and component 3 (attracting private shareholders). Component 1 comprised of two variables. These were handling client concerns and handling staff concerns. Component 2 comprised of three variables. These were guarding against mission drift, transfer of liabilities to new RFI, and creating governance structure (BOD). Component 3 comprised of two variables. These were transfer of assets to new RFI and attracting private owners.

The average scores for each re-named factor were first calculated. Descriptive statistics for the re-named factors were then calculated using the average scores for each re-named factor, the results of which are presented in Table 4.12. The results show that all the factors presented a low level of difficulty. Managing staff and clients presented the lowest level of difficulty (2.19). This may be explained by the fact that all the factors are involve processes that are internal to the transforming MFI and its internal stakeholders and do not involve the CBK.

Direct logistic regression was then performed to assess the impact of a number of factors on the likelihood that respondents would report that they had successfully transformed. The null hypothesis was stated as follows:

H_{03} *There is no significant effect of management of stakeholders on the transformation of microfinance institutions into deposit taking financial institutions in Kenya.*

Direct logistic regression was chosen because it is the appropriate technique where the dependent variable is dichotomous or categorical (Morgan & Griego, 1997; Pallant, 2007; Nicol & Pexman, 2010). In this study, the dependent variable (transformation status) was categorical (transformed / not transformed). The model contained three independent variables (factors). These were managing staff and clients, creating appropriate governance structures, and attracting private shareholders. The model was fitted as:

Logit (Transformation status) = 0.73 + 0.30(managing staff and clients) + 0.87(creating appropriate governance structures) + 0.18(attracting private shareholders)

The full results are presented in Table 4.13.

Table 4.13: Logistic Regression Predicting Likelihood of Reporting Successful Transformation from Managing Stakeholders Factors

Component	df	Sig.	Exp(B) (Odds Ratio)
Managing staff and clients	1	0.30	0.60
Creating appropriate governance structures	1	0.87	1.10
Attracting private shareholders	1	0.18	1.95
Constant	1	0.73	0.49

n = 47

χ^2 = 2.466; df = 3; Sig. = 0.481

Cox and Snell R square (0.051); Nagelkerke R square (0.068)

Overall percentage correct prediction (66%)

The full model containing all predictors was not statistically significant, χ^2 (3, N=47) = 2.466, P=0.48 indicating that the model was not able to distinguish between

respondents who reported and those who did not report successful transformation in Kenya. The model as whole explained only between 5.1% (Cox and Snell R square) and 6.8% (Nagelkerke R square) of the variance in transformation status, but correctly classified 66% of cases. None of the independent variables made a unique statistically significant contribution to the model. Therefore, the null hypothesis (H_{03}) that *there is no significant effect of management of stakeholders on the transformation of microfinance institutions into deposit taking financial institutions in Kenya* was accepted. It was concluded that managing stakeholders is not a significant challenge affecting the transformation of microfinance institutions into deposit taking financial institutions in Kenya. This supports results of the descriptive statistics presented in Table 4.11.

4.7 Institutional Change Management as a Challenge in the Transformation of MFIs into Deposit Taking Financial Institutions in Kenya

The fourth objective of this study was to determine whether institutional change management was a challenge affecting the transformation of microfinance institutions into deposit taking financial institutions in Kenya. There are 9 issues of institutional change management that have been reported to have presented challenges to transforming MFIs in other countries. The nine issues are developing new operational policies & procedures, developing new instruments like passbooks, adopting new ICTs like ATMs, adapting organizational culture and structure, meeting physical facility needs like premises, financing the transformation process, financing the expected expansion in operations, financing the expected expansion in lending, and raising equity.

The respondents were thus asked to indicate the level of difficulty in dealing with the above issues related to institutional change management occasioned by MFI transformation in Kenya. The responses were measured on a four point likert scale of 1 to 4 with 1 as 'very low', 2 as 'low', 3 as 'high' and 4 as 'very high' level of difficulty. Descriptive statistics were first calculated and the results are shown in Table 4.14.

Table 4.14: Descriptive Statistics for Level of Difficulty with Institutional Change Management

	N	Mean
Developing new operational policies & procedures	49	2.14
Developing new instruments e.g. Passbooks	49	1.98
Adopting new ICTs e.g. ATMs	51	2.57
Adapting organizational culture and structure	48	2.15
Meeting physical facility needs e.g. premises	48	2.23
Financing the transformation process	53	2.68
Financing the expected expansion in operations	52	2.77
Financing the expected expansion in lending	54	2.52
Raising equity	53	2.70

Key:
Mean of 1.00 - 2.44: Low level of difficulty
Mean of 2.45 – 4.00: High level of difficulty

The findings show that five out of the nine factors had high levels of difficulty, with financing the expected expansion in operations having the highest level of difficulty (2.77) in Kenya (see Table 4.14). The remaining four factors had low levels of difficulty, with developing new instruments like passbooks having the least level of difficulty (1.98). That MFIs faced a high level of difficulty with financing the expected expansion in operations confirms the assertion by Ledgerwood (1999) that transforming MFIs are often limited by a lack of funding sources because most of

them were initially created as semi-formal institutions (as NGOs or some form of savings and credit cooperative). As Campion and White (1999) argue, switching from donor funding to the more expensive commercial loans and deposits results in huge costs. At the same time, raising funds from public deposits can also be challenging because potential depositors may be apprehensive about the accessibility of their savings.

The findings were further subjected to factor and regression analysis. Factor analysis was used so as to decompose the information contained in a set of variables into information about an inherent set of latent components or factors. This assisted in reducing the number of variables into fewer factors which are of similar characteristics and isolating factors with main effects to the characteristics of the dependent variable (transformation status of MFIs).

A scrutiny of the correlation matrix of the factors making up the institutional change management variable revealed that there were 15 factors at 95% and 99% confidence interval with correlation coefficients of 0.3 and above (see Appendix 7). Thus the data for these variables was considered suitable for factor analysis. The resulting Total Variance Explained table revealed a total of three factors with eigenvalues of 1 and above. Together, these three factors accounted for 70.04% of the variance.

Through Principal Component Analysis (PCA) method, three factors were initially extracted. However, two variables loaded very strongly (more than 0.5) on two components each. These are financing the transformation process (loading strongly on component 1 and 2), and adopting new ICTs e.g. ATMs (loading strongly on

components 1 and 3). It was, therefore, decided to go for a 2-factor solution. The resulting Total Variance Explained table for the 2-factor solution revealed two factors with eigenvalues of 1 and above. Together, these two factors accounted for 56.34% of the variance. Eight of the variables loaded strongly on one of the components. However, the ninth variable (meeting physical facility needs like premises) did not have a loading on either component, because of the instruction to SPSS to suppress loadings below 0.3. This variable was, therefore, excluded from further analysis. The structure matrix of the two factors with their loadings is presented in Table 4.15.

Table 4.15: Structure Matrix and Means for Institutional Change Management Components

	Component	
	1	2
Financing the Expected Expansion in Operations	.817	-.427
Financing the Transformation Process	.811	-.480
Financing the Expected Expansion in Lending	.796	
Raising Equity	.723	
Adopting New ICTs e.g. ATMs	.626	
Adapting Organizational Culture and Structure		.841
Developing New Operational Policies & Procedures		.757
Developing New Instruments e.g. passbooks		.688
Means	2.53	2.08

Key:

- Variable Extraction Method: Principal Component Analysis; Rotation Method: Oblimin with Kaiser Normalization
- Criteria for factor analysis: loading of 0.5 and above on a component was accepted
- Mean of 1.00 - 2.44: Low level of difficulty; Mean of 2.45 – 4.00: High level of difficulty.

The resultant two components were then re-named as financing (component 1) and operations and culture (component 2). Component 1 comprised of five variables,

namely, financing the expected expansion in operations, financing the transformation process, financing the expected expansion in lending, raising equity and adopting new ICTs like ATMs. Component 2 comprised of three variables. These were adapting organizational culture and structure, developing new operational policies & procedures, and developing new instruments like passbooks. The average scores for each re-named factor were then calculated. Descriptive statistics for the re-named factors were then calculated using the average scores for each renamed factor as shown in Table 4.15.

Financing had a high level of difficulty (2.53) while operations and culture had a low level of difficulty (2.08) as shown in Table 4.15. That financing was found to be difficult can be attributed to the fact that an entity that was previously without owners is now required to seek owners (shareholders) as it transforms. Success in getting the shareholders, especially private shareholders, depends on the willingness of potential investors. This finding concurs with the position reported by Ledgerwood (1999) and Hishigsuren (2006). These results also confirm the findings from descriptive statistics presented earlier on in Table 4.14.

Direct logistic regression was then performed to assess the impact of a number of factors on the likelihood that respondents would report that they had successfully transformed. The following null hypothesis was tested:

H_{04} *There is no significant effect of institutional change management on the transformation of microfinance institutions into deposit taking financial institutions in Kenya.*

Direct logistic regression was chosen because it is the appropriate technique where the dependent variable is dichotomous or categorical (Morgan & Griego, 1997; Pallant, 2007; Nicol & Pexman, 2010). In this study, the dependent variable (transformation status) was categorical (transformed / not transformed). The model contained the two independent variables (factors), namely, financing and operations and culture.

The model was fitted as:

Logit (Transformation status) = 0.173 + 0.009(financing) + 0.421(operations and culture)

The full results are presented in Table 4.16.

Table 4.16: Logistic Regression Predicting Likelihood of Reporting Successful Transformation from Institutional Change Management Factors

Component	df	Sig.	Exp(B) (Odds Ratio)
Financing	1	0.009	0.194
Operations and culture	1	0.421	1.630
Constant	1	0.173	20.045

n = 48

χ^2 = 11.203; df = 2; Sig. = 0.004.

Cox and Snell R square (0.208); Nagelkerke R square (0.278)

Overall percentage correct prediction (60.4%)

The results show that the full model containing all predictors was statistically significant, χ^2 (3, N=48) = 11.203, P=0.004, indicating that the model was able to distinguish between respondents who reported and those who did not report successful transformation in Kenya (see Table 17). The model as whole explained between 20.8% (Cox and Snell R square) and 27.8% (Nagelkerke R square) of the variance in transformation status, and correctly classified 60.4% of cases. Only one of

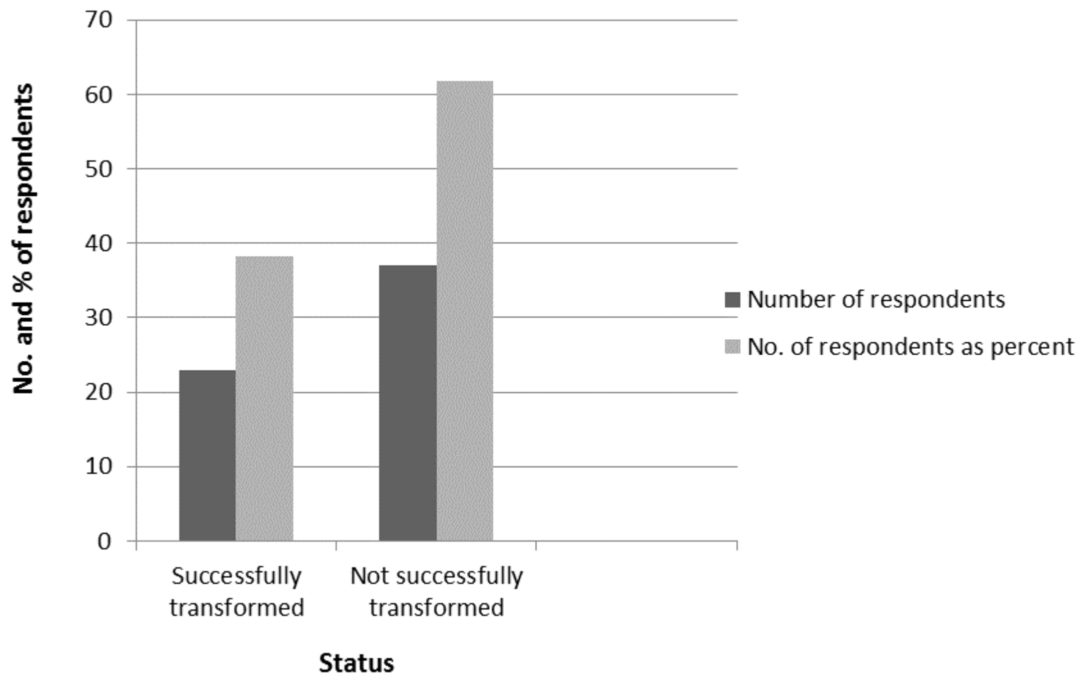
the independent variables (financing) made a unique statistically significant contribution to the model. The strongest predictor of reporting successful transformation was operations and culture, recording an odds ratio of 1.63. Therefore, the null hypothesis (H_{04}) that *there is no significant effect of institutional change management on the transformation of microfinance institutions into deposit taking financial institutions in Kenya* was disproved and rejected.

It was concluded that institutional change management was a significant challenge in the transformation of microfinance institutions into deposit taking financial institutions in Kenya. This indicated that respondents who had difficulty with managing operations and culture change were less likely to report successful transformation than those who did not have a difficulty with managing operations and culture change, controlling for all other factors in the model. Financing is challenging in that a previously ownerless entity is now seeking owners and success depends on the willingness of potential investors. This finding concurs with the position reported by Ledgerwood (1999) and Hishigsuren (2006). At the same time, it has been reported that adapting organizational structure and culture change is not always easy (Campion & White, 1999). According to Campion and White (1999), a transforming institution needs to adapt its organizational structure and culture because the structure and culture should be able to support the methodology and operations of the new MFI.

4.8 Transformation Status of MFIs into Deposit Taking Financial Institutions in Kenya

The dependent variable for this study was transformation status of MFIs. After an MFI undertakes the initial preparations for transformation, it applies for registration and licensing as a regulated deposit taking financial institution. Upon meeting all the requirements, the MFI is issued with a license by the Central Bank of Kenya authorizing it to commence operations as a DTM. In the context of this study, therefore, there were only two possible transformation statuses. These are "transformed" status (issued with a DTM license by the CBK) and "not transformed" status (not yet issued with a DTM license by the CBK).

The respondents were thus asked to indicate whether their MFIs had been issued with an interim license or letter of intent by the CBK. The results are presented in Figure 4.7.



n=60

Figure 4.7: Transformation Status

The findings show that 38.3% of the MFIs had transformed a proportion that was much lower than 61.7% of the MFIs who had not (see Figure 4.7). Some of the MFIs that had transformed were Equity bank, KWFT, and SMEP while Rafiki, Jamii Bora, and Uwezo were also licensed after meeting all the requirements.

However, it was noted that those who had not yet completed the transformation were at different stages in the process. This concurs with studies carried out in other countries that suggest that a relatively long period of time (2-3 years) was taken for transformation (Hishigsuren, 2006). This is attributed to the challenges faced in the process by the transforming MFIs. It also concurs with studies carried out in Kenya by Rosenngard *et al*., (2000) and Frankfurt School of Finance and Management (2012) which indicate that K-Rep, Faulu and KWFT took quite long to transform.

4.9 Suggestions for a Blueprint for Transformation of MFIs into Deposit Taking Financial Institutions in Kenya

In line with its overall objective, this study sought to also develop a blueprint for the transformation of microfinance institutions into deposit taking financial institutions in Kenya. Therefore, in addition to the data collected on the four specific objectives, the study sought other information from the respondents to make it possible to develop and recommend a blueprint for MFI transformation in Kenya. The additional data consisted of suggestions by the respondents of factors that were considered necessary for MFI transformation, the steps in the licensing process that were considered unnecessary, the role of CBK, the role of AMFI, and various types and sources of support considered necessary for transforming MFIs.

Based on the findings of this study, five basic ingredients for transformation were developed. These are the institutional profile, planning for transformation, legal compliance, management of stakeholders, and institutional change management. They are presented in Table 4.17.

Table 4.17: Basic Ingredients for MFI Transformation in Kenya

	Variable	Total no. of factors extracted	Number of factors found to be significant	Percentage of factors found to be challenges
1	Institutional Profile	4	1	25
2	Planning for Transformation	5	1	20
3	Legal Compliance	4	3	75
4	Managing Stakeholders	3	0	0
5	Institutional Change management	2	1	50

Key:

- Criteria for accepting a variable as a challenge: a minimum of 50% of the factors in a given variable established as a significant challenge.

From the analysis of the profile of the participating institutions, only one out of the four (25%) factors was found to be a significant challenge in Kenya (see table 4.17). From the planning for transformation variable, only one out of the five factors (20%) was found to be significant. From the legal compliance variable, 75% of the factors were found to be significant challenges. Managing stakeholders had none of its factors as a significant challenge while institutional change management had 50% of its factors as significant challenges.

The model for successful MFI transformation in Kenya, therefore, should contain legal compliance, institutional change management and one factor each from the MFI profile and planning for transformation. In addition, there are a number of factors that should be considered for successful transformation, based on the opinion of the respondents (see Table 4.18).

The respondents were asked to list, in the order of priority, the factors that would enable an MFI in Kenya to transform into a regulated deposit taking financial institutions. The factors identified by the respondents were funding, availability of

assets, support from staff, support from shareholders, government support, cooperation from clients, adequate infrastructure, and good reputation. The findings are presented in Table 4.18.

Table 4.18: Priority Ranking of Factors Considered Necessary for MFI Transformation

Factor	N	Percentage ranking by respondents based on priority					
		1	2	3	4	5	6
Funding	23	52.2	39.1	8.7	-	-	-
Availability of assets	3	-	100	-	-	-	-
Support from staff	8	25	25	50	-	-	-
Support from shareholders	8	62.5	-	-	25	-	12.5
Support from government	5	40	-	40	-	-	20
Cooperation from clients	6	83.3	-	-	16.7	-	-
Adequate infrastructure	10	10	30	20	40	-	-
Good reputation	4	-	100	-	-	-	-

Key:
Rank 1 represents the top/highest priority while ranking 6 represents the lowest priority.

The findings show that the most popular factor in Kenya was cooperation from clients, having been given the topmost priority ranking by 83.3% of the respondents (see Table 4.18). The least popular factor in Kenya was support from the government, which was ranked at the lowest priority number six by 20% of the respondents. This agrees with the assertion that a transforming institution faces the challenge of preparing its clients for the transition (Campion & White, 1999). The existing clients are legitimately anxious about their fate once the MFI transforms. For instance they may be worried about their eminent transfer the new entity.

On the licensing process in Kenya, respondents were asked to identify any of the steps that they considered unnecessary. The respondents were presented with a list of the

steps in the licensing process in Kenya and asked to indicate which ones they considered to be unnecessary. The list of steps in the licensing process comprise of: name search and reservation with the registrar of business names, approval of business name by the Central Bank, submitting application form & support documents, providing evidence of capital, submitting feasibility study and business plan, meeting “fit and proper” requirements for individual shareholders, meeting “fit and proper” requirements for corporate entities, issuance of letter of intent and final steps, and issuance of license and gazettement of the RFI as a DTM. The findings are presented in Table 4.19.

Table 4.19: Necessity of Various Steps in Licensing Process

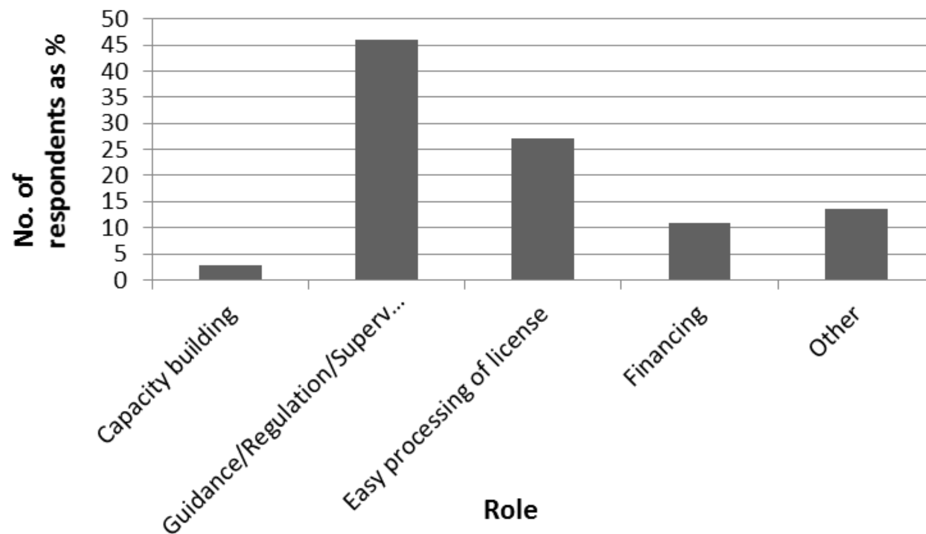
Step	N	No. of respondents as percent	
		Necessary	Unnecessary
Name search and reservation with the Registrar of Business Names	58	100	-
Name approval by CBK	58	98.3	1.7
Registration of business name	60	76.7	23.3
Submitting application form & support documents	58	100	-
Providing evidence of capital	58	89.7	10.3
Submitting feasibility study and business plan	59	76.3	23.7
Meeting fit and proper requirements for individuals	59	52.5	47.5
Meeting fit and proper requirements for corporate entities	59	81.4	18.6
Issuance of letter of intent and final steps	59	93.2	6.8
Issuance of final license and gazettement	59	96.6	3.4

(N = the total number of respondents in a given factor)

The findings show the majority of the respondents stated that all the steps in the licensing process in Kenya were necessary (see Table 4.19). Nevertheless, 47.5% of the respondents considered meeting fit and proper requirements for individuals as

unnecessary. This is the vetting for individual shareholders (CBK, 2008). This finding may be due to the large amount of information and supporting documents required for the vetting. Meeting this requirement is tedious and takes a lot of time.

The study further sought the opinion of the respondents on the role that the Central Bank of Kenya (CBK) and the Association of Microfinance Institutions (AMFI) should play to assist MFIs in transformation. The findings are presented in Figures 4.8 and 4.9.

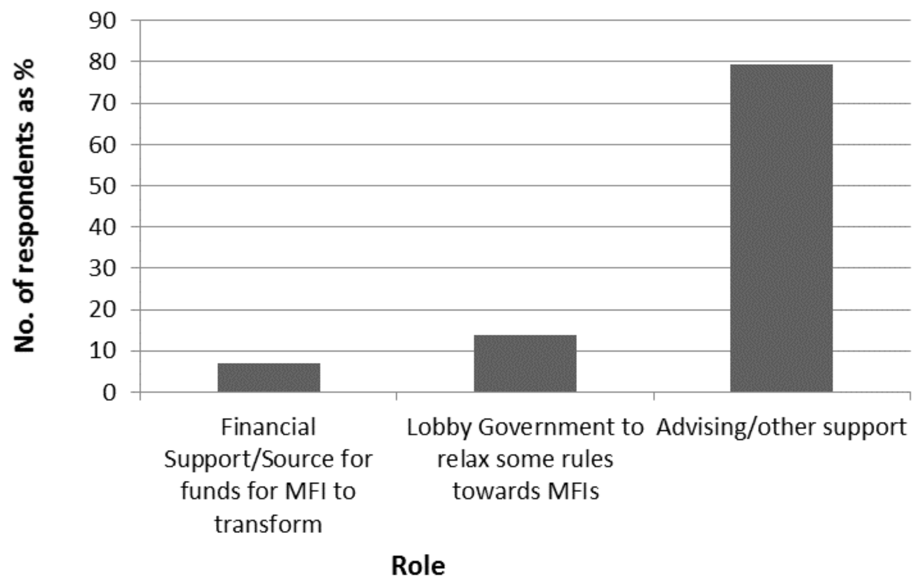


n= 37

Figure 4.8: Roles of CBK in MFI Transformation in Kenya

The findings show that most of the respondents (45.9%) felt that the role of CBK should be to guide, regulate and supervise the transforming MFIs in Kenya. The least cited role was capacity building (2.7%).

Findings regarding the role of AMFI are shown in Figure 4.9.



n= 29

Figure 4.9: Roles of AMFI in MFI Transformation in Kenya

The findings further show that most of the respondents (79.3%) felt that the role of AMFI should be to advice the transforming MFIs. This agrees with the study by Frankfurt School of Finance & Management (2012).

The study sought to find out whether the transforming MFIs received various kinds of support and if so, the sources of the support. The respondents were thus asked to indicate the type and sources of support, if any, that they received during the transformation process. The findings are presented in Table 4.20.

Table 4.20: Types and Sources of Support

Type of support and sources	N	No. of respondents as percent
Financial Support		
Shareholders/owners/Parent NGO	17	43.6
Banking Institution	18	46.2
Clients	4	10.3
Total	39	100.0
Professional/Expert Advice Support		
National Credit Reference Bureau	3	13.6
Research Institutions / Universities	1	4.5
Auditing / Accounting Firms	3	13.6
Legal Firms	13	59.1
Other e.g. staff	2	9.1
Total	22	100.0

(N= the total number of respondents in a given factor)

The findings show that two kinds of support to MFIs transforming in Kenya were identified. These are financial and professional/expert advice support (see Table 4.20). Two major sources of financial support were mentioned, that is, banks (46.2%) and shareholders (43.6%). Professional advice came mainly from legal firms (59.1%). This finding is consistent with the study by Frankfurt School of Finance & Management (2012).

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter presents a summary of the findings as well as the conclusions and recommendations of the study. The overall objective of this study was to determine the challenges that affect the transformation of microfinance institutions into deposit taking financial institutions in Kenya. The study had one dependent and four independent variables. The dependent variable was MFI transformation status while the independent variables were planning, legal compliance, management of stakeholders, and institutional change management. The summary, conclusions and recommendations of the study are presented along the objectives of the study.

5.2 Summary of Findings

5.2.1 Institutional Profile and MFI Transformation Status in Kenya

The sample for this study was 100 respondents from the target population of 25 institutions. From the target, a total of 60 respondents from 18 institutions participated in this study. The study collected background data on various aspects of the MFIs. The aspects of the MFIs on which the data was collected were the period of operating microfinance in Kenya, type of institution before seeking to transform, legal form of registration before seeking transformation, and the law under which transformation was sought. The other aspects on which data was collected were the current number of operational branches, number of active clients served, size of current loan portfolio, lending methodologies before and after seeking transformation, financial services other than credit being offered, reasons for transformation.

The data was analyzed using descriptive statistics and inferential statistics (Pearson Chi-square) to test whether institutional characteristics had a significant relationship with MFI transformation status. In particular, the study tested for the relationship between the period of microfinance operation in Kenya, number of operational branches, number of active clients, and the size of the loan portfolio and MFI transformation.

Out of the four aspects that were tested, the study found only one (25%) to be a significant determinant in the transformation status of MFIs in Kenya. This was the number of active clients that an MFI had. This means that the more the clients that an MFI had at the time of seeking to transform, the more the likelihood that it would succeed in transforming. This is consistent with the need to meet the needs of the growing number of clients which is one of the main objectives of MFI transformation (Ledgerwood & White, 2006; Frankfurt School of Finance & Management, 2012).

The other three MFI characteristics that were investigated, namely, the period of microfinance operation in Kenya, number of operational branches, and the size of the loan portfolio, were found not to have significant effects on MFI transformation in Kenya. That the period of microfinance operation in Kenya was not a significant determinant in the transformation of an MFI in Kenya was attributed to the fact that successful transformation is indicated by the issuance of license, a process that is largely outside the control of the MFIs. That the size of an MFI loan portfolio was not a significant determinant in the successful transformation of an MFI in Kenya was attributed to the fact that, unlike member deposits (which may be used for on-

lending), the existing portfolio does not increase or reduce the probability of transforming successfully.

5.2.2 Whether Planning is a Significant Challenge Affecting MFI Transformation in Kenya

The first objective of this study was to establish the effect of planning on the transformation of microfinance institutions into deposit taking financial institutions in Kenya. Planning for transformation was measured using five items, namely, convincing the board and management on the need to transform, assessing the readiness for transformation, agreeing and commissioning a transformation manager, preparing the transformation plan, and making initial consultations with the regulator, that is the CBK. Data for each item was analyzed using descriptive statistics and inferential statistics (Pearson Chi-square Test for Independence) to determine whether it had a significant association with the transformation status.

Out of the five planning items, only one item was found to have a significant association (20%) with transformation status of MFIs in Kenya. This was convincing the board and management on the need to transform, meaning that the difficulty faced in getting board and management approval was a significant determinant in the successful transformation of MFIs in Kenya. Therefore, the null hypothesis (H_{01}) that *there is no significant effect of planning on the transformation of microfinance institutions into deposit taking financial institutions in Kenya* was accepted. The study, therefore, concluded that to a large extent, planning was not a challenge

affecting the transformation of microfinance institutions into regulated deposit taking financial institutions in Kenya.

5.2.3 Whether Legal Compliance is a Significant Challenge Affecting MFI Transformation in Kenya

The second objective of this study was to determine the effect of legal compliance on the transformation of microfinance institutions into deposit taking financial institutions in Kenya. Legal compliance was measured using eleven items contained. Data for this variable was analyzed using descriptive statistics, factor analysis and inferential statistics (Direct Logistic Regression) to determine whether the variable was a significant challenge affecting transformation of microfinance institutions into deposit taking financial institutions in Kenya.

Through factor analysis, the eleven factors were reduced to four components. These are incorporation of business, application for license and documentation, issuance of license, and fit and proper test. Direct logistic regression model containing the four independent variables was then performed to assess the impact of the factors on the likelihood that respondents would report that they had successfully transformed. The full model containing all predictors was statistically significant, $\chi2$ (4, N=38) = 12.862, P=0.012 indicating that the model was able to distinguish between respondents who reported and those who did not report successful transformation. The model as whole explained between 28.7% (Cox and Snell R square) and 38.4% (Nagelkerke R square) of the variance in transformation status, and correctly classified 68.4% of cases. Therefore, the null hypothesis (H_{02}) that *there is no*

significant effect of legal compliance on the transformation of microfinance institutions into deposit taking financial institutions in Kenya was rejected. The study, therefore, concluded that legal compliance was a significant challenge in the transformation of microfinance institutions into regulated deposit taking institutions in Kenya.

5.2.4 Whether Management of Stakeholders is a Significant Challenge Affecting Transformation of MFIs in Kenya

The third objective of this study was to evaluate the effect of management of stakeholders on the transformation of microfinance institutions into deposit taking financial institutions in Kenya. Managing stakeholders was measured using seven items, namely, guarding against mission drift, attracting private owners, creating an appropriate governance structure (BOD), transfer of assets to the new RFI, transfer of liabilities to the new RFI, handling staff concerns, and handling client concerns. Data for this variable was analyzed using descriptive statistics, factor analysis and inferential statistics (Direct Logistic Regression) to determine whether the variable was a significant challenge in the transformation of microfinance institutions into deposit taking institutions in Kenya. Through factor analysis, the seven items were reduced to three components. These are managing staff and clients, creating appropriate governance structures, and attracting private shareholders.

The Direct Logistic Regression model containing the three factors was then performed to assess the impact of the three factors on the likelihood that respondents would report that they had successfully transformed. The null hypothesis (H_{03}) that

there is no significant effect of management of stakeholders on the transformation of microfinance institutions into deposit taking financial institutions in Kenya was thus tested using Direct Logistic Regression. The results were that the full model containing all predictors was not statistically significant, χ^2 (3, N=47) = 2.466, P=0.48 indicating that the model was not able to distinguish between respondents who reported and those who did not report successful transformation. The model as a whole explained between 5.1% (Cox and Snell R square) and 6.8% (Nagelkerke R square) of the variance in transformation status, and correctly classified 66% of cases. The null hypothesis (H_{03}) was accepted. It was, therefore, concluded that managing stakeholders was not a significant challenge affecting transformation of microfinance institutions into deposit taking financial institutions in Kenya.

5.2.5 Whether Institutional Change Management is a Significant Challenge Affecting Transformation of MFIs in Kenya

The fourth objective of this study was to examine the effect of institutional change management on the transformation of microfinance institutions into deposit taking financial institutions in Kenya. This variable was measured using nine items. These are developing new operational policies & procedures, developing new instruments like passbooks, adopting new ICTs like ATMs, adapting organizational culture and structure, meeting physical facility needs like premises, financing the transformation process, financing the expected expansion in lending, and raising equity. Data for the variable was analyzed using descriptive statistics, factor analysis and inferential statistics (Direct Logistic Regression) to determine whether the variable was a

significant challenge in the transformation of microfinance institutions into regulated deposit taking institutions in Kenya.

Through factor analysis, the nine items were reduced to two components, each comprising a number of factors. Component 1 was financing and comprised of financing the expected expansion in operations, financing the transformation process, financing the expected expansion in lending, raising equity, and adopting new ICTs like ATMs. Component 2 was operations and culture and it consisted of organizational culture and structure, developing new operational policies & procedures, and developing new instruments like passbooks.

Direct Logistic Regression model containing the two factors, namely, financing and operations & culture, was performed to assess the impact of the factors on the likelihood that respondents would report that they had successfully transformed. The null hypothesis (H_{04}) that *there is no significant effect of institutional change management on the transformation of microfinance institutions into deposit taking financial institutions in Kenya* was thus tested using Direct Logistic Regression. The results were that the full model containing all predictors was statistically significant, χ^2 (3, N=48) = 11.203, P=0.004, indicating that the model was able to distinguish between respondents who reported and did not report successful transformation. The model as whole explained between 20.8% (Cox and Snell R square) and 27.8% (Nagelkerke R square) of the variance in transformation status, and correctly classified 60.4% of cases. The null hypothesis was rejected. It was, therefore, concluded that institutional change management was a significant challenge in the transformation of microfinance institutions in Kenya.

5.3 Conclusions

According to the findings of this study, out of the five items making up the planning for transformation variable, only one (difficulty of convincing the board and management on the need to transform) was found to be associated with transformation status. This study, therefore, concludes that planning is not a significant challenge affecting the transformation of MFIs into deposit taking financial institutions in Kenya.

On legal compliance, the full model containing all predictors was statistically significant, indicating that the model was able to distinguish between respondents who reported and did not report successful transformation. This study thus concluded that legal compliance is a significant challenge affecting the transformation of microfinance institutions into deposit taking financial institutions in Kenya.

On the management of stakeholders, the full model containing all predictors was not statistically significant, indicating that the model was not able to distinguish between respondents who reported and those who did not report transformation. This study thus concluded that management of stakeholders was not a significant challenge affecting the transformation of microfinance institutions into deposit taking financial institutions in Kenya.

Regarding institutional change management, the full model containing all predictors for the institutional change management variable was statistically significant. This indicates that the model was able to distinguish between respondents who did and

those who did not report transformation. This study, therefore, concluded that institutional change management is a significant challenge affecting the transformation of microfinance institutions into regulated deposit taking institutions in Kenya to a large extent.

5.4 Recommendations

5.4.1 Planning for Transformation

Microfinance Institutions that intend to transform need to allow themselves adequate time to get through the process. This will enable them get to understand fully the environment and the legal and regulatory framework. They should also identify the types and sources of support that they will require beforehand.

In addition, MFIs intending to transform in Kenya need to commit a lot of time and resources to planning and initial preparations. This is because transformation is costly in terms of time and other resources. In particular, they should ensure that there is a consensus on the need to transform from both the board and management. They should also start making initial consultations with the CBK as early as when the idea of transforming first arises and a consensus on the need to transform is reached.

5.4.2 Legal Compliance

It is important for players in the sector to appreciate that the steps in the licensing process are not sequential. Transforming MFIs thus need to understand the steps in the whole transformation process upfront in order to be well prepared to meet the requirements of each step.

5.4.3 Management of Stakeholders

A transforming MFI needs to understand all her stakeholders in terms of their needs and how transformation is likely to affect them. The MFI should then put in place a clear plan of how it will manage each stakeholder.

5.4.4 Institutional Change Management

Institutional change management is a process that goes on long after legal transformation has been achieved. For instance, institutional and operational transformation goes on for much longer after an MFI has been issued with a license to operate as a DTM. Transforming MFIs should, therefore, mobilize adequate financial and other resources to enable them to successfully manage institutional and operational transformation after getting licensed to operate as a DTM.

5.4.5 Recommendations for Policy

At the moment, the law allows for licensing of transforming MFIs to operate as DTMs only after they meet all the legal requirements. Before then, an MFI cannot start piloting its products and services, especially deposits products. Given that the transformation takes a fairly long time, this study recommends a review the law to allow for phased transformation. This would make it possible for the Central Bank of Kenya to license transforming MFIs in phases as they move through the process in phases. For instance, the revised legal policy would allow CBK to issue a temporary or short term approval, followed by a partial license, and finally a full license.

The law should also be reviewed to formally recognize and support AMFI to make it play a more direct role in supporting transforming MFIs. In particular, it should

enable AMFI to set up a fund to finance transformations and provide capital for new DTMs.

Finally, the government should review its tax policy to make it more supportive to transforming MFIs. The law should then be changed to allow the transformed MFIs a tax holiday of, say, five years. The law should also exempt from tax any assets donated or transferred to the DTM by the mother NGO MFI. These policy changes will act as incentives and thus attract more MFIs to seek transformation.

5.4.6 Areas for Further Research

This study recommends several areas for further research. The first one is the impact of Microfinance regulation in Kenya. It is important to conduct research to establish the impact of transformation on clients, MFIs, the financial sector and the economy. Such a study should also establish whether the benefits of transformation justify the effort.

This study further recommends a study to determine the impact of MFI transformation on overall financial inclusion in the country. This is because the overall aim of transformation is to improve financial inclusion, especially for the poor.

This study also recommends further research to compare the experience of DTMs that transform from NGO MFIs and the experience of DTMs that are created as such from scratch. This will help development agencies and private investors in deciding whether to start microfinance operations as a DTM or as a non-deposit taking institution.

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APPENDICES

Appendix 1: Research Questionnaire

CHALLENGES AFFECTING TRANSFORMATION OF MICROFINANCE INSTITUTIONS INTO DEPOSIT TAKING FINANCIAL INSTITUTIONS IN KENYA

Serial No ...…..

***1. INSTITUTIONAL BACKGROUND** (GENERAL INFORMATION)/PROFILE*

A. REFERENCE

1. Name of Institution:

   ____

2. Location of head office (Town/City):

   ____

3. Date of Interview:

   ____

4. Place of Interview:

   ____

5. Name of Respondent (Optional):

   ____

6. Name of Interviewer:

   ____

B. INSTITUTIONAL BACKGROUND

For questions where a range of responses is given and only one response is requested, circle the most appropriate one. For questions requiring multiple responses, circle all the appropriate responses.

1. In which year did your institution start microfinance operations in Kenya?

   ____

2. What was the type of your institution before transforming?
    a. Microfinance institution (NGO owned)
    b. Microfinance institution (with private ownership)
    c. Wholesale microfinance institution
    d. Microfinance programme or project
    e. Savings and Credit Cooperative Society (SACCO)
    f. Other (Please specify)

    ____

3. Under what legal form was your organization registered before deciding to transform?
    a. Incorporated company limited by guarantee
    b. Incorporated company limited by shares
    c. Registered trust
    d. Self-help group / community based organization
    e. Non-governmental organization
    f. Other (*Please specify)* ___________________________________

4. Under what law did you seek transformation?
    a. Microfinance Act
    b. Banking Act
    c. Other (*Please specify)*

    ____

5. How many operational branches do you currently have? _____________

6. How many active clients does your institution serve at the moment?

    ____

7. What is the current size of your institution's loan portfolio in Kenya shillings? Ksh.__________________

8. Which of the following lending methodologies was your institution using before seeking to transform?
   a. Individual based lending
   b. Group based (lending to individual members through their groups)
   c. Group based (lending to group)
   d. Other (*Please specify)* ________________________________

9. Which of the following lending methodologies is your institution using currently?
   a. Individual based lending
   b. Group based (lending to individual members through their groups)
   c. Group based (lending to group)
   d. Other (*Please specify)* ________________________________

10. If you provide financial services other than credit (loans), please list them.
   a. ____
   b. ____
   c. ____
   d. ____

C. TRANSFORMATION RELATED ISSUES

1. The following are the major reasons for MFI transformation. Please rank them according to the priority that your organization placed on each one.

	Reason for transforming	**Priority / ranking** (e.g.1, 2, 3, 4, etc.)
a.	To access to additional sources of funds to support growth, profitability and sustainability	
b.	To offer a wider range of financial services and products	
c.	To improved efficiency and overall financial performance	
d.	To meet competition	
e.	To improve customer satisfaction	
f.	Others (Please specify): ____ ____	

2. Amongst the following stages/steps in the transformation process which ones have you already successfully completed?

   a. Initial planning for transformation and getting board approval
   b. Search and reservation of business name
   c. Approval of business name by the Central Bank
   d. Registration of business name
   e. Incorporation of the company
   f. Submission of License Application Form and support documents to CBK
   g. Providing evidence of capital
   h. Submitting feasibility study and business plan
   i. Meeting "Fit and Proper" requirements:
      1. For individual shareholders
      2. For Corporate shareholders
   j. Received Letter of intent/interim license
   k. Final license issued and gazetted
   l. Start of operations as DTM

2. PLANNING FOR TRANSFORMATION AS A CHALLENGE

3. Which of the following challenges did you experience when preparing for transformation?

   a. Convincing the board and senior management on need to transform
   b. Assessing readiness for transformation
   c. Agreeing on and commissioning a Transformation Manager/Team
   d. Preparing the transformation plan
   e. Making initial consultations with the CBK
   f. Others *(Please specify)*

      ____

      ____

3. LEGAL COMPLIANCE AS A CHALLENGE

4. Listed below are steps in the licensing process. Indicate the level of difficulty that you experienced in meeting the requirements of each step on a scale of 1 to 4 *(With 1 as the lowest and 4 as highest level of difficulty).*
   a. Name search – Registrar of business names: [1] [2] [3] [4]
   b. Name Approval by Central Bank: [1] [2] [3] [4]
   c. Application form & support documents: [1] [2] [3] [4]
   d. Providing evidence of capital: [1] [2] [3] [4]
   e. Submitting feasibility study: [1] [2] [3] [4]
   f. "Fit and Proper Forms"- Individual: [1] [2] [3] [4]
   g. "Fit and Proper Forms"- Corporate: [1] [2] [3] [4]
   h. Other requirements – local applicants: [1] [2] [3] [4]
   i. Other requirements– foreign subsidiaries: [1] [2] [3] [4]
   j. Letter of intent and final steps: [1] [2] [3] [4]
   k. Issuance of license: [1] [2] [3] [4]

4. MANAGEMENT OF STAKEHOLDERS AS A CHALLENGE

5. Listed below are issues related to management of stakeholders occasioned by transformations. Indicate the level of difficulty that you experienced in dealing with each of the issues on a scale of 1 to 4 (W*here 1 is the lowest and 4 the highest level of difficulty).*
   a. Guarding against mission drift: [1] [2] [3] [4]
   b. Attracting private owners: [1] [2] [3] [4]
   c. Creating governance structure (BOD): [1] [2] [3] [4]
   d. Transfer of assets to new RFI: [1] [2] [3] [4]
   e. Transfer of liabilities to new RFI: [1] [2] [3] [4]
   f. Handling staff concerns: [1] [2] [3] [4]
   g. Handling client concerns: [1] [2] [3] [4]

5. INSTITUTIONAL CHANGE MANAGEMENT AS A CHALLENGE

6. The following issues occasioned by transformations are related to institutional change management. Indicate the level of difficulty that you experienced in dealing with each of the issues on a scale of 1 to 4 (W*here 1 is the lowest and 4 the highest level of difficulty).*
   a. Developing new operational policies & procedures: [1] [2] [3] [4]
   b. Developing new instruments e.g. passbooks: [1] [2] [3] [4]
   c. Adopting new ICTs e.g. ATMs: [1] [2] [3] [4]
   d. Adapting organizational culture & structure: [1] [2] [3] [4]
   e. Meeting physical facility needs, e.g. premises: [1] [2] [3] [4]

7. The following are issues related to financial needs occasioned by transformations. Indicate the level of difficulty that you experienced in dealing with each of the issues on a scale of 1 to 4 (W*here 1 is the lowest and 4 the highest level of difficulty).*
   a. Financing the transformation process: [1] [2] [3] [4]
   b. Financing the expected expansion in operations: [1] [2] [3] [4]
   c. Financing the expected expansion in lending: [1] [2] [3] [4]
   d. Raising equity: [1] [2] [3] [4]
   e. Others *(Please specify)*______________________ [1] [2] [3] [4]

8. Please indicate the organizations that provided you with the different kinds of assistance listed below.

	Nature of assistance	**Organizations**
1	Financial support	____________________________________ ____________________________________
2	Professional / expert advice	____________________________________ ____________________________________
3	Capacity building services	____________________________________ ____________________________________
4	Other *(Specify):*______________ ____________________________	____________________________________ ____________________________________

D. SUGGESTIONS FOR SUCCESSFUL TRANSFORMATION

9. List in the order of priority the factors that would enable an MFI to transform into a regulated deposit taking financial institutions successfully.
   a. ____
   b. ____
   c. ____
   d. ____

10. Which of the following steps in the licensing process would you consider unnecessary?
    a. Name search – Registrar of business names
    b. Name Approval by Central Bank
    c. Application form & support documents
    d. Providing evidence of capital
    e. Submitting feasibility study
    f. “Fit and Proper Forms” for individuals
    g. “Fit and Proper Forms” for corporate entities
    h. Letter of intent and final steps
    i. Issuance of license

11. What role should the Central Bank play to assist Microfinance Institutions to transform successfully?

    ____

12. What role should the Association of Microfinance Institutions (AMFI) play to Microfinance Institutions to transform successfully?

    ____

THANK YOU VERY MUCH FOR PARTICIPATING IN THIS STUDY

Appendix 2: Letter of Introduction

George Koome Rukaria
JKUAT
P.O. Box 62000
NAIROBI
Tel: 0722 691 454
Email:
rukariag@yahoo.com

5 April 2013

____

____

____

Dear respondent,

RE: INVITATION TO PARTICIPATE IN STUDY ON MFI TRANSFORMATION INTO DEPOSIT TAKING INSTITUTIONS

I am a student at Jomo Kenyatta University of Agriculture and Technology pursuing a doctoral degree programme in entrepreneurship. I am undertaking this research as part of the requirements of the University programme. The study seeks to establish the challenges that affect transformation of microfinance institutions into deposit taking financial institutions in Kenya, with a view to proposing a transformation blue-print.

I am inviting your organization to participate in the study. The findings will be useful to individual MFIs, the sector, policy makers, and scholars in the area of regulation and supervision of deposit taking microfinance institutions. All information provided will be treated with the utmost confidence.

Yours sincerely,

G. K. Rukaria

Appendix 3: Sampling Frame

S/N	Name of MFI	Location (HQs)	Focus/Type of Organization	Whether Selected	Remarks
1	AAR Credit Services	Nairobi	Insurance/Health	No	Insurance / Health
2	ADOK TIMO	Kisumu	MF	No	In Kisumu
3	AgaKhan Foundation	Nairobi	General enterprise development	No	General enterprise development
4	AIG Kenya Insurance	Nairobi	Insurance	No	Insurance
5	Barclays Bank of Kenya Ltd	Nairobi	Commercial Bank	No	Commercial Bank
6	BIMAS	Embu	MF	No	In Embu
7	Blue Limited	Nairobi	MF	Yes	MFI
8	Canyon Rural Credit Limited	Nairobi	MF	Yes	MFI
9	CIC Insurance	Nairobi	Insurance	No	Insurance
10	Co-operative Bank	Nairobi	Commercial Bank	No	Commercial Bank
11	Elite Secondary Mortgages & Microfinance	Mombasa	MF	No	In Mombasa
12	Equity Bank Limited (EBL)	Nairobi	MF Bank	Yes	MF Bank
13	Faulu Kenya	Nairobi	MF	Yes	MFI
14	Fusion Capital Ltd	Nairobi	MF	Yes	MFI
15	Jamii Bora Bank	Nairobi	MF Bank	Yes	MF Bank
16	Jitegemea Credit Scheme	Nairobi	MF	Yes	MFI
17	Jitegemee Trust Ltd	Nairobi	MF Wholesaler	No	Wholesaler
18	Juhudi Kilimo Company Limited	Nairobi	MF Programme	No	A K-Rep Bank programme
19	K-rep Bank Ltd	Nairobi	MF Bank	Yes	MF Bank
20	K-rep Development Agency	Nairobi	General enterprise development NGO	No	General enterprise development
21	KADET	Nairobi	MF	Yes	MFI
22	Kenya Eclof	Nairobi	MF	Yes	MFI
23	Kenya Entrepreneur	Kiambu	MF	No	In Kiambu

S/N	Name of MFI	Location (HQs)	Focus/Type of Organization	Whether Selected	Remarks
	Empowerment Foundation (KEEF)				
24	Kenya Gatsby Trust	Nairobi	MF Wholesaler	No	Wholesaler
25	Kenya Post Office Savings Bank	Nairobi	Savings Bank	No	Savings Bank
26	Kenya Women Finance Trust	Nairobi	MF	Yes	MFI
27	MIC Microcredit limited	Nairobi	MF	Yes	MFI
28	Micro Africa	Nairobi	MF	Yes	MFI
29	Molyn Credit Limited	Nairobi	MF	Yes	MFI
30	OIKO CREDIT	Nairobi	MF Wholesaler	No	Wholesaler
31	Opportunity International	Kisumu	MF	No	In Kisumu
32	Pamoja Women Development Programme (PAWDEP)	Kiambu	MF	No	In Kiambu
33	Renewable Energy Technology Assistance Programme (RETAP)	Nairobi	MF	Yes	MFI
34	Rupia Limited	Nairobi	MF	Yes	MFI
35	SISDO	Nairobi	MF	Yes	MFI
36	SMEP	Nairobi	MF	Yes	MFI
37	Swiss Contact EA	Nairobi	MF & General Enterprise Development	No	General enterprise development
38	Taifa Option Microfinance	Ruiru	MF	No	In Thika
39	U & I Microfinance Limited	Nairobi	MF	Yes	MFI
40	Women Economic Empowerment Consort (WEEC)	Kiserian	MF	No	In Ngong
41	Yehu Enterprises Support Services	Kwale	MF	No	In Kwale
42	Greenland Fedha	Nairobi	MF	Yes	MFI

S/N	Name of MFI	Location (HQs)	Focus/Type of Organization	Whether Selected	Remarks
43	One Africa Capital	Nairobi	MF	Yes	MFI
44	Platinum Credit	Nairobi	MF	Yes	MFI
45	Rafiki DTM	Nairobi	MF	Yes	MFI
46	Remu DTM Ltd	Nairobi	MF	Yes	MFI
47	Uwezo Microfinance	Nairobi	MF	Yes	MFI
48	Micro and Small Enterprise Trust Programme (MSETP)	Nairobi	MF Wholesaler & General enterprise development	No	Wholesaler & General enterprise development

Appendix 4: Approaches to the Provision of Microfinance

	Approach	Goal	Characteristics	Outcome	Constraints
1	**Poverty Lending**	- Avail financial credit for poverty reduction	- Only financial credit availed - Services provided by NGO MFIs that have no shareholders (owners) - Use of grants and / or donor funds	- A methodology for credit provision to the poor developed - Unsustainable microfinance institutions due to poor / weak governance and management structures - Donor fatigue and demands for sustainability - Unsustainable service provision due to limited resource base - Limited outreach / limited capacity to serve large numbers of poor people with wide range of products - Financial exclusion sustained	- Limited sources of funding and financial base - Ownerless NGO MFIs - Dependency
2	**Commercial Microfinance (Financial System)**	- Provide financial services to a large number of the poor sustainably	- A variety of financial services availed – e.g. credit, savings, insurance, money transfer, low cost housing, etc - Services provided by sustainable (commercially viable) microfinance institutions - Service providers mobilize resources from a variety of sources: Shareholders' capital contribution, commercial funds, public deposits, other income - Competition amongst MFIs	- Increased outreach, thus higher financial inclusion level - Sustainable (commercially viable) microfinance institutions - Sustainable provision of financial services - Improved capacity to serve large sections of the public - Entry of more institutions into microfinance sector, thus competition leading to improved services, thus sustainable provision of financial services	- Lack of or inappropriate legal framework - Transformation of NGO MFIs into regulated financial institutions - Conflict between goal of mass outreach and sustainability

Appendix 5: Correlation Matrix for Legal Compliance Factors

		1	2	3	4	5	6	7	8	9	10	11
1	Pearson Correlation	1										
	Sig. (2-tailed)											
	N	59										
2	Pearson Correlation	.067	1									
	Sig. (2-tailed)	.642										
	N	50	50									
3	Pearson Correlation	.206	.248	1								
	Sig. (2-tailed)	.148	.093									
	N	51	47	51								
4	Pearson Correlation	.395**	-.259	-.213	1							
	Sig. (2-tailed)	.004	.079	.134								
	N	51	47	51	51							
5	Pearson Correlation	.665**	-.305*	-.004	.450**	1						
	Sig. (2-tailed)	.000	.037	.978	.002							
	N	47	47	47	47	47						
6	Pearson Correlation	-.429**	.111	.054	-.386**	-.389**	1					
	Sig. (2-tailed)	.003	.458	.717	.007	.007						
	N	47	47	47	47	47	47					
7	Pearson Correlation	-.015	.460**	.499**	-.244	-.062	.396**	1				
	Sig. (2-tailed)	.923	.002	.001	.110	.687	.008					
	N	44	44	44	44	44	44	44				
8	Pearson Correlation	-.136	.275	.251	-.282	-.280	.603**	.620**	1			
	Sig. (2-tailed)	.385	.075	.104	.067	.069	.000	.000				
	N	43	43	43	43	43	43	41	43			
9	Pearson Correlation	.368*	-.268	-.249	.650**	.505**	-.242	-.370*	-.444**	1		
	Sig. (2-tailed)	.023	.104	.132	.000	.001	.143	.022	.005			
	N	38	38	38	38	38	38	38	38	38		
10	Pearson Correlation	-.074	-.107	-.099	.297	-.003	-.325*	-.433**	-.351*	.203	1	
	Sig. (2-tailed)	.646	.504	.538	.059	.984	.038	.005	.024	.222		
	N	41	41	41	41	41	41	40	41	38	41	
11	Pearson Correlation	.089	-.087	.068	.003	.046	-.097	-.093	.050	-.241	.580**	1
	Sig. (2-tailed)	.585	.595	.678	.983	.780	.550	.570	.758	.144	.000	
	N	40	40	40	40	40	40	40	40	38	40	40

**. Correlation is significant at the 0.01 level (2-tailed).

*. Correlation is significant at the 0.05 level (2-tailed).

Key:

1	Name search - registrar of business names
2	Name approval by central bank
3	Application form and support documents
4	Providing evidence of capital
5	Submitting feasibility study and business plan
6	Submitting "fit and proper forms"- individual
7	Submitting "fit and proper forms"- corporate
8	Meeting other requirements - local applicants
9	Meeting other requirements - foreign subsidiaries
10	Getting letter of intent and final steps
11	Getting issued with license

Appendix 6: Correlation Matrix for Management of Stakeholders Factors

		1	2	3	4	5	6	7
1	Pearson Correlation	1						
	Sig. (2-tailed)							
	N	53						
2	Pearson Correlation	.115	1					
	Sig. (2-tailed)	.420						
	N	51	53					
3	Pearson Correlation	.291*	-.040	1				
	Sig. (2-tailed)	.040	.783					
	N	50	50	50				
4	Pearson Correlation	-.320*	.382**	-.128	1			
	Sig. (2-tailed)	.028	.008	.392				
	N	47	47	47	47			
5	Pearson Correlation	.367*	.022	.082	-.157	1		
	Sig. (2-tailed)	.011	.881	.586	.291			
	N	47	47	47	47	47		
6	Pearson Correlation	-.186	.395**	-.102	.244	.005	1	
	Sig. (2-tailed)	.195	.005	.487	.099	.971		
	N	50	50	49	47	47	50	
7	Pearson Correlation	-.129	.200	-.172	.094	-.184	.590**	1
	Sig. (2-tailed)	.373	.163	.236	.529	.215	.000	
	N	50	50	49	47	47	50	50
*. Correlation is significant at the 0.05 level (2-tailed).								
**. Correlation is significant at the 0.01 level (2-tailed).								

Key:

1 Guarding against mission drift
2 Attracting private owners
3 Creating governance structure (BOD)
4 Transfer of assets to new RFI
5 Transfer of liabilities to new RFI
6 Handling staff concerns
7 Handling client concerns

Appendix 7: Correlation Matrix for Institutional Change Management Factors

		New Operational Policies & Procedures	Developing New Instruments e.g. passbooks	Adopting New ICTs e.g. ATMs	Adapting Organizational Culture/ Structure	Meeting Physical Facility Needs	Financing Transformation Process	Financing the Expected Expansion in Operations	Financing the Expected Expansion in Lending	Raising Equity
Developing New Operational Policies & Procedures	Pearson Correlation	1								
	Sig. (2-tailed)									
	N	49								
Developing New Instruments e.g. passbooks	Pearson Correlation	.210	1							
	Sig. (2-tailed)	.147								
	N	49	49							
Adopting New ICTs e.g. ATMs	Pearson Correlation	.077	.186	1						
	Sig. (2-tailed)	.599	.201							
	N	49	49	51						
Adapting Organizational Culture and Structure	Pearson Correlation	.537**	.480**	-.102	1					
	Sig. (2-tailed)	.000	.001	.490						
	N	48	48	48	48					
Meeting Physical Facility Needs e.g. premises	Pearson Correlation	.220	.092	-.213	.013	1				
	Sig. (2-tailed)	.133	.533	.147	.932					
	N	48	48	48	48	48				
Financing the Transformation Process	Pearson Correlation	-.226	-.404**	.367**	-.478**	.040	1			
	Sig. (2-tailed)	.118	.004	.010	.001	.786				
	N	49	49	49	48	48	53			
Financing the Expected Expansion in Operations	Pearson Correlation	-.305*	-.229	.447**	-.401**	-.122	.788**	1		
	Sig. (2-tailed)	.035	.117	.001	.005	.408	.000			
	N	48	48	48	48	48	52	52		
Financing the Expected Expansion in Lending	Pearson Correlation	.029	-.157	.376**	-.094	-.026	.591**	.522**	1	
	Sig. (2-tailed)	.846	.288	.007	.526	.862	.000	.000		
	N	48	48	50	48	48	52	52	54	
Raising Equity	Pearson Correlation	.061	-.014	.222	.033	.175	.447**	.487**	.471**	1
	Sig. (2-tailed)	.678	.923	.126	.822	.233	.001	.000	.000	
	N	49	49	49	48	48	53	52	52	53

**. Correlation is significant at the 0.01 level (2-tailed).

*. Correlation is significant at the 0.05 level (2-tailed).