# Challenges of Transformation Process from Microfinance to Microfinance Bank and its Effects on the Bank's Activities. Case of Unguka Bank LTD

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**ABSTRACT**

Challenges issues that are critical to the growth and health of any profitmaking organization are inherent to the business. To survive, the organization requires going through different stages ranging from creation and sometimes ending by decline. The theory applies to the financial sector as a dynamic industry. In the same perspective the study of the challenges of transformation process from microfinance institution to microfinance bank taking into consideration UNGUKA BANK Ltd focused on describing how these challenges affected the bank's activities. It applied descriptive research design. Research questions were generated and empirical documents were technically used to expand insight on the existing literature. The data was collected from the UNGUKA BANK Ltd at Headquarter, located in Kigali City. Respondents were 32 and questionnaires have been distributed for the collection of primary data and Statistical Package for Social Sciences (SPSS) was a tool to analyze data. From findings, the study revealed that the major challenges of Unguka Microfinance in the transformation process are mainly related to staff. On one hand, all staff did not contribute to the process of transformation and on the other hand, staffs were not skilled enough in banking operations to drive and sustain the process of transformation. Findings revealed also that benefits of transformation outweigh the challenges encountered on the growth-path of the process of transformation of Unguka Bank Ltd. The study recommends however to the new comers in the transformation journey to pay attention to clear understanding and engaging of the whole staff in the process. To prepare a well trained and highly qualified staff that is computer friendly skilled can be among important steps in transformation process.

**Key words**: Challenges, Transformation process, Microfinance Institution, Microfinance Bank, Bank's activities

## Introduction

Any profit making organization requires going through different stages of growth ranging from creation and sometimes ending by decline. The banking sector as a dynamic industry is not left aside from this process. As this research seeks to find out lessons that can be drawn from challenges associated with institution's transformation process.

Banks are firms that offer financial services. They collect funds (deposits) from units in surplus of funds and lend them to those in deficit of funds at a given interest rate. They bridge the gap between the needs of lenders and borrowers (Casu, Girardone and Molyneux, 2006). Together with deposit and lending services, banks perform also other services including: payment services, investments, pensions, insurance services, financial advisory, E-banking. Banks serve their customers and provide satisfactory returns to shareholders. Their objective is to maximise shareholders 'wealth.

As banking industry is dynamic business (Rose, 2002), it has to go through a positive growth process if it has to survive. The targeted growth implies a process of transformation in term of capital, infrastructure, organisational structure, management systems, and personnel among others. However, this transformation process poses some challenges. For example, the capital may not be enough to satisfy the clients; organizational structure may not be appropriate to the target phase of growth and development; employees may not be skilled at the level of carrying out the new structure. In microfinance area, recent experience of BancoSol in Bolivia in the 1992 as argued by Hishigusern (2006) proves that its upgrade from microfinance to commercial bank faced challenges where some were appearing general as growth process is concerned whereas other were totally specific. In Rwanda, the upgrade from Microfinance Institution Ltd to intermediate banks, called Microfinance Bank started in 2011 when Agaseke Microfinance Ltd, Urwego Opportunity Microfinance Ltd and Unguka Microfinance Ltd accessed that new status (NBR, 2013). Even though success or failure cannot be fully duplicated, they provide lessons to new comers in the business, which is the aim of this study concerning the transition from Microfinance

Institution Ltd to microfinance bank Ltd of Unguka.

Financial services are very important for the economy. They are like a channel that links different economic agents. They aim at increasing accessibility of financial services to citizens and encourage people to use financial institutions. They enable them to save and access to loans and ultimately providing them with the opportunity to build financial security that would better contribute to manage financial shocks and to invest in business opportunities. This would, in turn, allow the users of these institutions to move out of continuing poverty and improve their living conditions.

Concerning the development of financial sector, the Rwandan financial sector is still relatively less developed and is dominated by Commercial banks which represent more than 70 percent of the total deposit the system receives (NBR, 2013). Another constraint to the sector is that 43% to 28% of adult population did not have access to formal banking services between 2008 and 2012. In tempting to solve this problem, the Government of Rwanda in her Vision 2020 has encouraged the establishment of microfinance institutions which are about 491 of which 13 are limited companies and 478 are SACCOs, including 416 Umurenge

SACCOs. It is also on this pathway where 3 microfinance institutions upgraded to Microfinance Bank Ltd. However, this upgrading process is not smooth, it goes with challenges. This study aims at finding out the potential challenges through which microfinance institutions go in the process of transformation into intermediate or commercial bank, taking Unguka Bank Ltd UB Ltd) as a case study.

## Materials and Method

In order to have this work done and accomplished efficiently, descriptive research design was used. Its choice is based on the fact that it allows the researcher to integrate the effects of the process of transformation of Unguka microfinance Ltd into Unguka Bank Ltd on its business into the study. The examined literature informed the construction of the research instrument used in gathering reliable and unbiased data. The use of descriptive is preferred on the judgement that it provides an easy way to quantify the statistics of the respondents and other variables. Therefore, describing the judgment of respondents expands the understanding and answer the predetermined research questions as mentioned in chapter one.

## Population and sampling Techniques

Population is the entire set of individuals of interest to a research. Although the entire population usually does not participate in a research study, the results from the study are generalized to the entire population (Gravether & Forzano, 2003).

The research study was conducted at Unguka Bank Ltd having its Head Office in Kigali City. The population of this study comprises all employees who have at least four years of experience in Unguka Bank Ltd. Their number is 38. The choice of this population is based on their knowledge on the process of transformation of Unguka Bank Ltd.

A sample is a set of individuals selected from a population and usually is intended to present the population in a research study (Gravether & Forzano, 2003). This study adopts a purposive sampling technique because a purposive sampling technique allows the researcher to use selected cases that will best enable him/her to explore the research questions in depth (Matthews & Ross, 2010).

In this study the sample size is 36 employees who were purposively selected from full-time workers who are working at UB Ltd at Head Office located in Nyarugenge District (Nyarugenge Sector) and are either in a position of Senior Manager, Head of Department or responsible of a service, and were available at the period of collecting data.

## Research Instruments

The success of the research depends on the quality of the data collected, efficiency of respondents and the validity of the instrument used in the collection of data. The research employed a self structured questionnaire that covered all the variables under study, and was verified and proof read by the researchers before being used for data collection. The researchers also has proceeded to a document review to complete the data that was gathered through questionnaire. The document review concerns a review of action plans, reports, evaluations and documents related to financial and economic life of Unguka Bank Ltd. The questionnaire is in English. The questionnaire has three parts: The first part captures the identification of respondents: age, level of education, gender and experience. The second part is on challenges to transformation process. The third part focused to collect information regarding Unguka Bank Ltd's business after the transformation process was implemented. The questionnaire used a likert five-point

scale. A likert scale is easy to construct, to administer, and to understand. So, the response rate is encouraged and answers are somehow consistent. The scaling is composed of 5 scales and their interpretation depends on the nature of the question asked. Note that out of 36 questionnaires distributed only 32 were returned.

### Data analysis techniques

During the research, the researchers applied SPSS (Statistical Package for the Social Science) in the presentation of findings, analysis and discussion. Descriptive statistics were used in the research. Mean, standard deviations were taken into consideration to make the analysis.

## Results and Discussions

This chapter focuses on the analysis of the data gathered from 32 customers of UB Ltd. The data is presented in tables and then analyzed. The chapter is chronologically arranged to give statistical answers to the research questions addressed in chapter one of this research. The statistical analysis was done using the Statistical Package for Social Sciences (SPSS). In this research, the researchers have divided the questionnaire into two big parts. Part one relates to respondents' profile named the respondents demography in the questionnaire and part two relates to the proper questionnaire.

**Perceptions of respondents about the transformation process of Unguka Bank Ltd and activities**.

**Table 1 Perceptions of respondents on Legal environment**

| Questions | Mean | Std. Deviation |
|---|---|---|
| How would you consider the microfinance regulation in Rwanda | 3.96 | .646 |
| How would you consider the banking regulation in Rwanda? | 4.18 | .470 |
| How would you describe the appropriateness of banking regulation for your operations in Rwanda when envisaging the transformation? | 3.78 | .490 |
| How would you describe the ability of Unguka Microfinance Ltd in minimum capital to meet the requirements of microfinance bank? | 4.21 | .706 |

*Source: Primary data*

In table 1 all responses to specific questions have aggregate mean greater than 3.5 meaning that the employees perceive strongly that the legal environment in Rwanda was conducive during the process of transformation. The decision to transform into a regulated financial institution is heavily influenced by the country's regulatory environment. Transforming MFIs need to examine carefully the pros and cons of each regulatory category before selecting the institutional type best suited to their operations. This process represents the beginning of a long-term relationship that must be carefully built with regulators through a variety of exchanges, including visits, discussions, letters, and information sharing. (Churchill, Craig, editor. 2005).

**Table 2 Perceptions of respondents on Institutional capacity**

| Questions | Mean | Std. Deviation |
|---|---|---|
| How can you rate the action plan for the transformation that had Unguka Microfinance Ltd | 3.812 | .965 |
| How can you rate the efficiency of the information management system that had Unguka Microfinance Ltd during the process of transformation | 3.843 | .677 |
| How would you describe the standardized loans policies and procedures that had Unguka Microfinance Ltd before embarking on the transformation process? | 4.406 | 5.284 |
| How would you describe the standardized human resource management policies and training manuals that had Unguka Microfinance Ltd in this process of transformation? | 3.750 | .622 |
| How do you consider the cost-benefit analysis of the transformation process? | 3.687 | .820 |
| How would you describe the involvement of all staff of Unguka Microfinance Ltd in this process of transformation? | **3.468** | .873 |

*Source: Primary data*

In table 2, except the involvement of all staff in the process of transformation having an aggregate mean of 3.468 which is less than 3.5 meaning that the process was not owned by all staff. Other aspects of institution capacity in leading the process of transformation are on the strong side as

evidenced by an aggregate mean greater than 3.5 for other remaining variables.

The set of skills required of staff will change as microfinance and transform into regulated financial institutions. Whether the organization chooses to hire additional bankers, re-train its existing staff, or to apply a combination of the two, MFIs need to be aware of the significant amount of time and money required (Campion and White 2001).

**Table 3 Perception of respondents on Costs of transformation**

| Questions | Mean | Std. Deviation |
|---|---|---|
| How do you rate the estimated cost of transformation? | 3.843 | .919 |

*Source: primary data*

From table 3, as the aggregate mean is greater than 3.5 it means that the employees perceive strongly that the cost of transformation was somehow low. Generally, by the new structure, additional costs were incurred related to the transformation of the institutional image in connection with the new structure such as relocation of Head Office, its equipment, and the equipment of all branches, training of staff, the acquisition of new core banking.

To survive in an increasing competitive marketplace, microfinance institutions need to cut down on costly transactions and increase their efficiency. This is expected to improve their overall financial performance which may significantly affect their ability to meet some of the social goals stated earlier on. (Campion, A. and V. White 2001).

**Table 4 Perception of respondents on Benefits of transformation**

| Questions | Mean | Std. Deviation |
|---|---|---|
| How would you describe the possibility to mobilize new clients in response to products offered by the new structure? | 3.750 | .842 |
| How would you describe the easy access to sufficient fund from the public? | 3.843 | .723 |

*Source: primary data*

Table 4 displays a situation where the employees perceive strongly that the benefits of transformation were considered as fair. All aggregates mean are greater than 3.5 meaning that fairly the transformation allowed UB Ltd to mobilize new clients and have access to more fund including public ones. In most countries, regulation prevents unregulated, non-profit microfinance institutions to mobilize savings. By transforming into a regulated financial institution, they can provide a wider range of financial services, including savings. This will allow them not only to access this relatively stable source of local resources4, but also to expand their outreach by attracting a larger pool of clients. (Campion, A. and V. White 2001)

**Table 5 Perception of respondents on Stabilization of the new structure**

| Questions | Mean | Std. Deviation |
|---|---|---|
| How would you rate the compliance with the status of microfinance bank in term the loan do deposit ratio? | 3.840 | .723 |
| How would you rate the adaptability of available human resource to the new status of microfinance bank? | 3.656 | .787 |
| How would you rate the actual core banking system to the new structure? | 4.093 | .530 |
| How would you rate the process of reaching corporate segment of customers with the new structure? | 3.812 | .644 |
| What would you rate the process of staff training to cope with skills demanded in the new structure? | 3.375 | .751 |
| How do you rate the fulfillment of the social mission of Unguka Microfinance Ltd by the new structure? | 3.71 | .581 |

*Source: Primary data*

From table 5, except the requirement in skills to drive and stabilize the process of transformation where the aggregate mean 3.375 is between 1- 3.49 pointing out a weak situation, other variables are found to be strongly contributing to the stabilization of UB Ltd with the process of transformation because for all, the aggregate mean is greater than 3.5.The new structure reached out to enroll new customers who initially were not ready to work with Unguka Microfinance Ltd evidenced by a mean of

about 3.812. It allowed the institution to access other sources of funds such as the term deposit of Rwanda Social Security Board (RSSB), SORAS among others.

Transformation is sought to access other sources of capital more rapidly and to increase leverage. For example, they have access to additional sources of funds, such as central bank discount window, voluntary savings and funds channeled to only regulated financial institutions which will lead to the portfolio growth and ensure long-term sustainability for the institution, adaptability of human resource, a large core banking system, staff training are the good indicators of institution stability. (Campion, A. and V. White 2001).

## Conclusion

This chapter seeks to make a summary of the study and provides a conclusion and recommendations. It is important to note that, in carrying out this research the overall objective was to get informed about challenges of the way of transformation from microfinance institution to microfinance bank taking into consideration Unguka Bank Ltd in order to draw lessons that may help new applicants to the level of microfinance bank. The research was conducted at UB Ltd at its Headquarter, where a sample of 36 employees was selected purposively, and 32 employees returned their questionnaires. The general objective of this study was to get informed about challenges of the way of transformation from microfinance institution to microfinance bank in order to draw lessons that may help new applicants to the level of microfinance bank. The specific objectives were to examine effects associated with challenges encountered in the process of transformation of Unguka Bank Ltd from Unguka microfinance Ltd and to establish the relationship of those effects on the growth of business in UB Ltd. During our research, three fundamental questions were taken into consideration that are the following: Findings revealed that in the case of UB Ltd, the major challenges of Unguka Microfinance transformation process are mainly related to staff. On one hand, all staff did not contribute to the process of transformation (see table 07) where the aggregate mean is 3.468 less than 3.5. On the other hand staff were not skilled enough in banking operations to drive and sustain the process of transformation (see table 10) where the aggregate mean from is 3.375 which is less than 3.5 stipulating a weak situation.

The effects associated with the challenges encountered in the process of transformation

process of Unguka Bank Ltd are related to a poor performance that the bank experienced due to the capacity of staff which did not have solid skills in banking operations. A given number of staff did not cope with the new requirements. This has led to restructuring the bank in 2013 with the aim to bring in new competences in banking operations (UB, 2013). In that period, the bank experienced a high turnover of employees where the bank recorded a resignation of about 40 employees in 2013; say a turnover of about 8% per year while in past it used to be less than 1%. The limited skills of staff in banking operations combined with the turnover of employees resulted in a situation of poor analysis of loans application, poor recording and low rate of loans recovery leading to an increase of non-performing loans where the write offs loans reaching 1.4% from 1.1% in 2011 and affecting the efficiency and profits of the bank (UB, 2013). To preserve its social mission and negociate with a strategic investor, Unguka Bank Ltd structured its shareholding structure. Original shareholders were grouped in Unguka Invetment Group Ltd (UIG Ltd) with the objective of easing negociations in order to retain the majority of shares. The case was witnessed when Rural Impulse Fund II (RIF II) invested in UB Ltd in 2012 where UIG Ltd holds 64.28% and RIF II holds 35.72%.

In conclusion therefore, the objectives of the research have been successfully attained. The challenges faced by Unguka Bank Ltd in the process of transformation from microfinance institution to microfinance bank are namely is relation with the involvement of staff and its quality to drive and sustain the process of transformation. The effects associated with the challenges encountered in the process of transformation process of Unguka Bank Ltd were a poor performance of the bank due to the limited skills of employees in banking operations to drive and sustain the new structure.

- The relationship between the limited skills of staff and the turnover of employees on the growth of business in Unguka Bank Ltd is the slow growth of UB Ltd activities because non-performing loans have increased at the point where the write offs loans reaching 1.4% from 1.1% in 2011. Comparing advantages and disadvantages of transformation, one can conclude that benefits of transformation out weight the costs. The cost of transformation was perceived to be low and benefits associated with it to be fair. It is possible that the success of UB Ltd be attributed to the strong commitment of its leaders, given that the

Chief Executive Officer, who initially was the leader of the team that prepared the project to establish Unguka Microfinance Ltd was in the business of transformation and is still in position and the commitment of the Board.

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