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Financial Performance in the Selected Microfinance Institutions in Uganda

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Abstract

This study was undertaken to examine the degree of financial performance in the selected Microfinance institutions central region, Uganda. The ex- post facto or retrospective, prospective designs and descriptive survey design, and specifically descriptive comparative and descriptive correlation strategies were employed. A minimum sample of 266 was used in data collection and analysis. Data was analysed using means and t-test. The findings revealed that the degree of financial performance in the microfinance institutions in central region Uganda is high with an overall average mean of 3.09 this implies that that most financial institutions in Uganda are financially sound. The contingency theory by Joan Wood wards (1958) as cited and explained by Simons' (1995) levers of management system control model was authenticated and validated. The conclusion was drawn that the degree of financial performance in the microfinance institutions in central region Uganda was generally high and it was recommended that Microfinance institutions should enhance financial reporting framework to improve on the liquidity position, improve assets value, market share, financial sustainability as well as portfolio quality

Key Words

Financial ,Performance, Microfinance , Institutions

Introduction

The Microfinance sector in Uganda is made of formal and informal microfinance finance institutions (Hanning 2000). The formal institutions are either companies which are regulated under the banking laws; financial intermediaries which are not banks but regulated by the government as Microfinance Deposit taking Institutions; non-regulated companies that offer only credits; or formally registered cooperatives and societies that serve their members. The formal institutions are members of the Association of Microfinance Institutions of Uganda.

Micro finance industry is undergoing a big change instigated by a paradigm. First it was known as rural finance, later it became a micro enterprise finance then it became micro credit an integrated approach and then it evolved into the moderate approach in the early 1990's, in the late 1990, it became micro finance and now commercialization is the latest paradigm (Rutherford, 2002). The underlying thinking is that micro finance institutions must adopt commercial approach

According to the Ministry of Finance (2000), Microfinance became an issue for the Ministry of Finance and Economic Planning as well as the Bank of Uganda, as both made themselves acquainted with national and international experiences and practices. The unwillingness or inability of the formal financial institutions to provide financial services to the urban and rural poor, coupled with the un sustainability of government sponsored development financial schemes contributed to the growth of private sector-led microfinance in Uganda.

The evolution of Micro finance institutions in Uganda was a direct response to the failure of past attempts by government and donor funded rural credit programmes to reach poor families and landless households within the rural areas (Abbink 2002). Coupled with this is the fact that the small scale business people targeted by Micro finance institutions did not have the traditional collateral which is the basis for loan acquisition to the formal banking sector. The first Micro finance institutions appeared is South Asia almost twenty years ago, but have since spread to Latin America, South East Asia and more recently Africa, China, the South Pacific.

Uganda is generally seen as the country with the most vibrant and successful microfinance industry in Africa. Some microfinance institutions have experienced strong growth and are now reaching a considerable number of clients, (Bategekea 1999).

Microfinance came to be viewed as the most obvious vehicle for delivering financial services to the urban and peri-urban low-income earners as well as to the rural population (Opiokello 2000).

Access to credit is a major issue among the rural poor, and microfinance institutions, and loan schemes are designed to fulfil this demand. Such organizations often teach community members about the benefits and methods of saving, while offering micro-loans to start small businesses. Along with microfinance opportunities, socio economically excluded Ugandans need micro enterprise creation and development training to effectively utilize credit.

In times of rapid changes and increasing competition, the top management, corporate quality managers, financial controllers, and systems managers need to design Management Control Systems which help companies to achieve leading positions in terms of operational quality, productivity and financial break through. Management control is thus becoming increasingly complex across most industries (Carpenter 2000). In some cases, this increased effort seems to pay off in terms of positive financial returns. However, Microfinance Institutions show a short sustainability and weaknesses in enhanced management control practices or initiatives which seemed successful and beneficial for other industries. Microfinance institutions are expressing more emphasis on using executive ability and control system for solving management and decision issues such as cost difference analysis, performance evaluation and budget execution.

Microfinance institutions in Uganda are always often faced with high operating costs to provide financial services to the poor people and Small and Medium Enterprises (Micro banking Bulletin 1998). As more microfinance institutions grow and become formal financial institutions, each Microfinance Institution has a unique profile and operational structure that determines which types of controls are appropriate to increase financial performance.

Most Microfinance Institutions in Uganda are unable to meet their obligations when they come due usually resulting from poor cash flow planning, failure to monitor portfolio quality closely and take action when necessary. Portfolio quality has deteriorated more rapidly in Microfinance institutions than in traditional financial institutions due to the short-term and unsecured nature of micro lending, micro loan portfolios which tend to be more volatile (Ssewanyana 2009). And most microfinance institutions are currently, independently financially sustainable.

Literature Review

Financial Performance

According to Stoner (2003), financial performance in financial institutions refers to the ability to operate efficiently, profitability, survive grow and react to the environmental opportunities and threats. In agreement with this, Sollenberg & Anderson (1995) asserts that, performance is measured by how efficient the enterprise is in use of resources in achieving its objectives.

Hitt, *et al* (1996) believes that many firms' low performance is the result of poorly performing assets. Low performance from poorly performing assets is often related to strategic errors made in the acquisition process.

According to Dixon *et al* (1990), appropriate performance measures should which enable organizations to direct their actions towards achieving their strategic objectives. Kotey & Meredith (1997) contends that, performance is measured by either subjective or objective criteria, arguments for subjective measures include difficulties with collecting qualitative performance data from small firms and with reliability of such data arising from differences in accounting methods used by firms. Kent (1994) found out that, objective performance measures include indicators such as profit growth, revenue growth, return on capital employed.

Hitt, et al., (1996) mention accounting- based performance using three indicators: return on assets, return on equity, and return on sales.

According to Kotler (1992), strong performer firms are those that can stay in business for a good number of years. Dwivedi (2002) also found out that, the ability of a firm to survive in business in an indicator of good financial performance.

Uganda, about 90% of Ugandan SMEs collapse within 3 years Katuntu (2005). This is therefore an indicator of poor financial performance.

Financial performance in this study was conceptualized in terms of financial sustainability, profitability, and market share and portfolio management.

Financial sustainability: The indicator of performance of a micro finance institution is its financial Sustainability. According to Meyer (2002), there are two kind of sustainability that we could observe in assessing MFIs performance: Operational self sustainability and financial self-sustainability. Operational self-sustainability is when the operating income is sufficient enough to cover operational costs like salaries, supplies, loan losses, and other administrative costs. And financial self-sustainability which he referred as high standard measure is when MFIs can also cover the costs of funds and other forms of subsidies received when they are valued at market prices.

Meyer (2002) indicated, measuring financial sustainability requires that MFIs Maintain good financial accounts and follow recognized accounting practices that provide full transparency for income, expenses, loan recovery, and potential losses.

The attainment of financial sustainability is a key component of institutional financial viability, as identified in a case study of the Federation of Thrift and Credit Cooperative Societies in Sri Lanka (Hulme & Mosley, 1996). Attainment of financial sustainability will allow the microfinance institution to graduate towards providing larger and more complex loans to a more sophisticated clientele, The most popular way advocated to achieve financial sustainability is to increase the interest rates charged on loans, such that the spread between interest rates received on loans and that paid on savings, is enough to cover costs. This involves a shift away from subsidised interest rates (Ahmad,1996).

Profitability: A Profit is financial benefit that is realized when the amount of revenue gained from a business activity exceeds the expenses, costs and taxes needed to sustain the activity. Profitability in Microfinance is simply the difference between total revenue and total cost. Thus, the factors which affect financial institutions profitability would be those which affect institutions' revenue and costs. Hence, the impact of the internal and external determinants of institutions profitability will be analysed with a view to their impact on bank revenue and costs.

In analysing how well any given bank is performing, it is often useful to contemplate on the return on assets and the return on equity as used by Bourke Thornton (1992). The choice of the profitability ratio will depend on the objective of the profitability measure. The return on assets is primarily an indicator of managerial efficiency. It indicates how capable the management of the bank has been in converting the institution's assets into net earnings.

A bank's revenue is basically generated from its assets. However, it is worth nothing that not all assets generate revenue. Thus, the assets of a bank can basically be classified as income or revenue generating and non-income generating.

Market Share: An increase in the market price of an asset also called appreciation, Growth capital also called expansion capital and growth equity is a type of private equity investment, most often a minority investment, in relatively mature companies that are looking for capital to expand or restructure operations, enter new markets or finance a significant acquisition without a change of control of the business. Institutions that seek growth capital will often do so in order to finance a transformational event in their lifecycle.

Null Hypothesis

The null hypothesis tested in this study was that: There is no significant difference in the degree of financial performance between the selected microfinance Institutions

The Methodology

The study employed the ex post facto or retrospective, prospective designs and descriptive survey design, and specifically descriptive comparative and descriptive correlation strategies, data was collected using a standardized questionnaire with questions relating to the demographic characteristics of respondent and financial performance of the selected Microfinance Institutions. The Cronbach's Alpha coefficient test indicated that the questionnaires where reliable since the coefficient was above 0.5 (α=0.859). Using the Sloven's formula, a minimum sample size of 266 was obtained from the sample population of 792. Data was collected using a combination of purposive and systematic sampling and simple random sampling, from a sample of 266 respondents from the selected Microfinance institutions in central region, Uganda and analysed using summary statistics, such as means and ranks. The null hypothesis was tested using the t-test, correlations and regression analysis

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Findings

The degree of Financial Performance in the selected Microfinance institutions in central region, Uganda

The overall financial performance of microfinance in central region Uganda is high (overall mean =3.09) this implies that that most financial institutions in Uganda are financially sound and are strong and are profitable because Profitability is the primary goal of all business ventures. Without profitability the business will not survive in the long run. So measuring current and past profitability and projecting future profitability is very important and this clearly shows weather the microfinance institutions in central region Uganda are a going concern

Table 1: The degree of Financial Performance in the selected Microfinance institutions in, Uganda

Item	Mean	Interpretation	Rank
Financial Performance			
Profitability	3.22	High	1
Financial Sustainability	3.21	High	2
Portfolio Quality	2.97	High	3
Market share	2.93	High	4
Total Average Mean	**3.09**	High	

Source: Primary Data (2012)

Legend

Mean Range	**Response Mode**	**Interpretation**
3.26-4.00	Strongly Agree	Very High
2.51-3.25	Agree	High
1.76-2.50	Disagree	Low
1.00-1.75	Strongly Disagree	Very Low

Table 2: The Degree of Financial Performance between the Selected Microfinance Institutions in Uganda

	Category	Mean	T	Sig.	Interpretation	Decision on Ho
Financial performance	MFI A	3.1595	2.453	.015	Significant difference	Rejected
	MFI B	3.2323				

Source: Primary Data 2012

N.B. If the significant value is equal or less than 0.05 level of significance, the interpretation is **significant.**
If the significant value is more than 0.05 level of significance, the interpretation is **not significant**

Table 2 indicates that the views of the respondents in terms of financial performance in MFI B (mean =3.2323) is higher than in MFI A (mean = 3.1595), suggesting a difference in the degree of financial performance. The significance of this difference was supported by the t value (t = 2.453) which was small since its sig value (.015) was less than Sig = 0.05 resulting in to rejection of the null hypothesis and acceptance of the alternative hypothesis to the effect that there is a significant difference in degree of financial performance between the selected microfinance institutions in Central region Uganda at five percent level of significance (0.015< 0.05)

The study findings confirm earlier findings (Cull 2007) regarding differences in profitability levels between different microfinance institutions in Uganda. And also the findings of Pak. (2010) in his study while analyzing Financial Performance of financial institutions in India it was revealed that financial institutions in India perform differently in terms of profitability, capital growth and financial sustainability.

Conclusion

The overall findings on financial performance indicated that the microfinance institutions in Uganda are financially sound and are strong and are profitable because Profitability is the primary goal of all business ventures. Without profitability the business will not survive in the long run. So measuring current and past profitability and projecting future profitability is very important and this clearly shows weather the microfinance institutions in central region Uganda are a going concern

The degree of financial performance differ significantly between the Selected Micro finance institutions in central region Uganda

Recommendations

Microfinance institutions should enhance financial reporting framework to improve on the liquidity position, improve assets value, market share, financial sustainability as well as portfolio quality

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