

**THE NATURE OF COMPETITION WITHIN MICRO
FINANCE INDUSTRY IN KENYA**

UNIVERSITY OF NAIROBI
MADE TO ORDER

BY:

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DECLARATION

I, declare that this is my original work that has not been submitted to any other college, institution or university other than the University of Nairobi for academic credit.

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DEDICATION

To my beloved wife Jacqueline and my children Mark, Leigh and Sheenah for their understanding, support and inspiration.

ABSTRACT

Competition within an industry is one of the factors other than the regulatory, technological, economic, and commercial forces that determine its structure. It puts players into a world in which they have less control than they previously had and which will be characterized by continual change. The Kenyan microfinance marketplace has evolved at a very rapid pace with new entrants, new products and practice, a rise in movement between microfinance institutions and multiple memberships of financial institutions. The clientele have also become more demanding and discerning. It has many players and competition takes place in many fronts. The purpose of this study was to investigate the nature and basis of the competition in this industry using the Porters' Five Forces model.

This study used a descriptive survey design. The population was all the 18 MFIs in Kenya that are members of the Association of Micro Finance Institutions (AMFI). A semi-structured questionnaire was used and quantitative data on the respondents' perception to competition was obtained. The study found out that indeed competition as experienced by the players was reported to exist on all the fronts modeled by Porter. MFIs however did not give due credence to the impact of competition on their chances of success relative to other factors. The study recommended that MFIs pay attention to product development. This can be achieved through proper market prospecting and market research.

TABLE OF CONTENTS

DECLARATION	ii
DEDICATION	iii
ABSTRACT	iv
TABLE OF CONTENTS	v
LIST OF TABLES	vii
LIST OF FIGURES	viii
CHAPTER ONE: INTRODUCTION	1
1.1 Background	1
1.1.1 Concept of Competition Forces	1
1.1.2 Background of Microfinance industry in Kenya	3
1.2 Statement of the Research Problem	7
1.3 Objectives of the Study	8
1.4 Significance of the Study	8
CHAPTER TWO: LITERATURE REVIEW	10
2.1 Industry Competition	10
2.2 Five Forces Framework for industry competition.	13
2.3 Effects of Industry Competition	14
2.4 Effects of Competition in the MFI Industry	18
2.5 Summary	23
CHAPTER THREE: RESEARCH METHODOLOGY	25
3.1 Research design	25
3.2 The Population	25
3.3 Data collection	26
3.4 Data analysis	27
CHAPTER FOUR: RESEARCH FINDINGS AND INTERPRETATION	28
4.1 Profile of Respondent Firms	28
4.2 Basis of Competition	32
4.3 Factors shaping competition within the industry	35

4.3.1	Threat of New Entrants as a Force of Competition	35
4.3.2	Threat of Substitutes as a Force of Competition.....	37
4.4.3	Bargaining Power of Financial Suppliers as a Force of Competition.....	40
4.4.4	Bargaining Power of Customers as a Force of Competition.....	42
4.4.5	Rivalry among existing competitors as a Force of Competition.....	43

CHAPTER FIVE: SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS.....	46
5.0 Introduction.....	Error! Bookmark not defined.
5.1 Summary of findings.....	46
5.2 Conclusion	48
5.3 Recommendations.....	49
5.4 Areas for Further Research	49
REFERENCES.....	50
APPENDIX: QUESTIONNAIRE.....	52

LIST OF TABLES

Table 1: Estimated Demand for Credit in Kenya, International Project Consult (May 1998).....	5
Table 2: Concerns of MFIs before and during competition.....	19
Table 3: Years in operation.....	28
Table 4: Number of employees.....	29
Table 5: Company Ownership.....	31
Table 6: Intensity of competition faced over the last 3 yrs.....	32
Table 7: Main competitors as perceived by MFIs.....	33
Table 8: Ranking of factors influencing competition.....	34
Table 9: Extent to which new entrants affect competition.....	36
Table 10: Ranking of factors perceived to facilitate new entrants into the industry.....	36
Table 11: Accessibility to substitutes products/services to customers.....	37
Table 12: Extent of substitutes contributing to competition.....	38
Table 13: Extent of customer access to substitutes.....	39
Table 13: Responses to whether financial suppliers in MFI industry have bargaining power.....	40
Table 15: Extent of factors affecting bargaining power of financial suppliers.....	41
Table 16: Basis of bargaining power of customers.....	42
Table 17: Rivalry among existing competitors.....	43
Table 18: Extent of customer access to substitutes.....	44

LIST OF FIGURES

Figure 1: Porters five forces model.....	15
Figure 2: Profile of target customers	30
Figure 3: Responses to whether new entrants affect the competition.....	35
Figure 4: Extent of customer access to substitutes	44

CHAPTER ONE: INTRODUCTION

1.1 Background

1.1.1 Concept of Competition Forces

Competition is at the core of the success or failure of firms. Competition determines the appropriateness of a firm's activities that can contribute to its performance, such as innovations, a cohesive culture, or good implementation. Two central questions underlie the choice of competitive strategy. The first is the attractiveness of industries for long-term profitability and the factors that determine it. Not all industries offer equal opportunities for sustained profitability, and the inherent profitability of its industry is one essential ingredient in determining the profitability of a firm. The second central question in competitive strategy is the determinants of relative competitive position within an industry (Porter, 2004).

Competition within an industry is one of the factors other than the regulatory, technological, economic, and commercial forces that determine its structure. According to Porter's (1980) five forces framework, there are five principal forces that determine industry competition - the threat of new entrants, the threat of substitution, the bargaining power of buyers, the bargaining power of suppliers and, finally, the rivalry amongst existing competition in the industry.

Competition puts players into a world in which they have less control than they previously had and which will be characterized by continual change. Therefore, understanding forces shaping competition is important for the operators because of the need to appropriately allocate scarce resources and institutionalize appropriate coping

strategies needed to counter these forces. The exercise of creating successful coping strategies brings people from different parts of the organization together and thus enhances the chances of successful implementation through ownership of ideas.

Competitive advantage can be defined as having an edge over rivals in attracting customers and defending against competitive forces (Thompson et al). There are many sources available to firms for providing competitive advantage. In an industry Competitive advantage grows fundamentally out of value a firm is able to create for its buyers that exceeds the firm's cost of creating it. Value is what buyers are willing to pay, and superior value stems from offering lower prices than competitors for equivalent benefits or providing unique benefits that more than offset a higher price.

There are two basic types of competitive advantage: cost leadership and differentiation. Firms can gain a cost advantage or they can differentiate themselves. The choice of competitive scope, or the range of a firm's activities, can play a powerful role in determining competitive advantage.

Creating strategies for coping with competition is the heart of strategic management which is critical for the long term survival of any organization (Mogoki, 2002). For any firm to adequately create coping strategies there is need to understand the factors that are shaping competition within the industry. Then, competitive strategies can be formulated to exploit these opportunities and avoid threats. The need to make coping strategies emanates from the need for institutional survival and growth. The environment is dynamic, posing various opportunities and threats thus requiring different survival strategies and capabilities.

1.1.2 Background of Microfinance industry in Kenya

Microfinance refers to small-scale financial services – primarily credit and savings – provided to people at local levels in developing countries, both rural and urban (Robinson 2001). Microfinance was originally associated with innovations such as the Grameen Bank in Bangladesh which pioneered by lending to members of groups. Group members provide security and due to peer pressure within group, members encouraged each other to ensure prompt payment of the loans (Chambers, 2003). However, the term has acquired a broader definition and covers any financial service reaching those excluded from the formal banking sector and involving small transactions (Christen, 2001).

Worldwide, micro credit arose in 1980 as a result of research recommendations concerning the government delivery of subsidized credit to the poor people. Microfinance projects were set up by international aid organizations and local institutions such as Grameen bank in Bangladesh and Fundusz mikro in Poland with the sole of purpose of promoting small enterprises. In the developing world the aim of micro finance is that of helping others help themselves (Hulme and Edwards, 1997).

Micro finance is associated with Micro Finance Institutions (MFIs) which are specialized institutions registered under various acts to provide alternative financial services to the small and micro enterprises (SMEs) clientele. These institutions emerged in the mid eighties following the realization that even though SMEs played a critical role in job creation and poverty reduction they could not receive financial assistance from formal institutions because they were considered risky. Furthermore, many SME owners could not meet all the conventional requirements of the formal institutions. Main activities of

MFIs include group formation, small loans, savings and business development services BDS. MFIs are registered in various forms of organizations, such as NGO's, cooperatives society, and commercial banks (Ledgerwood, 2002). The clientele of this sector are economically active running stable small and micro enterprises in urban, peri-urban and rural centers; they are therefore not the poorest as may be implied.

The idea of micro credit can be traced back to before independence in Kenya. The colonial government did not provide credit facilities to the African people and hence informal groups such as merry go rounds were formed within the communities in rural areas and clan levels.

The Government of Kenya, many international donor agencies and a large number of Kenyan NGOs consider micro-finance as a key instrument for micro enterprise development and poverty alleviation. The Central Bureau of Statistics (1999) estimates the total number of NGOs providing financial services to low-income people at 130. This includes a tiny selection of banking institutions, about 60 Financial Service Associations and some 4,000 Savings and Credit Cooperative Societies (SACCOs).

In 1970s government agents were set up with the main focus of providing credit to those who had no previous access to credit facilities. The government and donor community assumed the poor required cheap credit and as a result credit unions were set up in an effort to mobilize savings among the poor people. The favorable attitudes and policies toward micro enterprise both world wide and locally owe much to the 1972 International Labor Organization ILO mission to Kenya. The report of that mission highlighted the

limitation of previous industrial development policies in Kenya (and by extension in much of the developing world) (Henry et al. 1991).

In Kenya the microfinance market penetration rate is estimated at around 10.4 per cent and loan portfolio by end year 1999 at around Kshs 2.3 billion (Central Bureau of Statistics, 1999 and Aleke Dondo, 2001). This was about 6.3% of the total demand for credit, which was then estimated at Kshs 36.5 billion in 1998 (Table 1).

Table 1: Estimated Demand for Credit in Kenya, International Project Consult (May 1998)

Population Group	Estimated number (million)	Average credit needs (Kshs)	Estimated volume of credit (Kshs)(billion)
Micro and small-scale enterprises	2.4	15,000	27.1
Small holder farms	2.0	2,800	3.3
Lowly paid wage and salary workers	1.7	18,000	6.1
TOTAL	6.1	8,950	36.5

Adapted from Aleke Dondo (2001): microfinance in Kenya, an overview; K-Rep occasional paper no 33

The Kenyan microfinance marketplace has evolved at a very rapid pace with new entrants, new products and practice, a rise in movement between and multiple memberships of financial institutions; and a more demanding and discerning clientele. This has significant implications for the many and various financial service providers operating in this increasingly competitive microfinance market.

This increasingly competitive and varied marketplace is beginning to be reflected in a growing number of players. This represents an important change, since until the early

1990's, most MFIs did not have to worry about competition. Many enjoyed near monopolies and saw huge untapped markets before them. The idea of competing for clients was very far from the mindset of early MFIs. This period of low competition allowed microfinance institutions the freedom to focus single-mindedly on making the breakthroughs in methodology and management necessary to reach scale and sustainability. However, recent years have seen competition amongst MFIs growing in leaps and bounds in Kenya. Moreover, donors have questioned the need for continued subsidies, resulting in the recent focus on "institutional sustainability" in the MFI sector.

The industry exists in an amorphous form which is not very well defined. Almost any one who feels they can offer microfinance services just joins in due to lack of regulation and monitoring. All these players contribute in shaping the competition within the industry as they target the same clientele. The MFIs therefore have to position themselves appropriately in order to survive within the dynamic environment in which they operate. Strategic decisions are normally about trying to achieve some advantage for the organization over competitors by adapting to the environment.

MFIs that wish to survive competition must learn to look outside themselves, by adding an externally focused set of competencies in the areas of market research and analysis of competitive advantage. This requires the development of new tools and internal processes. MFIs should gain a deep understanding of their clients and of their own areas of competitive advantages. They should focus their strategies around enhancing their

advantages, particularly the kinds of advantages that will help them adapt to the continual change that competition will create in the microfinance marketplace.

1.2 Statement of the Research Problem

Competition is having a profound effect on MFIs, seen most readily in the increase of interest in market research and new product development. These changes are bringing significant benefits to clients as MFIs become more customer-oriented. But for microfinance institutions, competition makes operations much more challenging. Microfinance is a fairly new industry that started to emerge in significant form in the 1980s. Prior to this period what was more common was integrated small enterprise development, which was more development oriented. Since then microfinance has proved to be an effective tool for poverty reduction through provision of financial services to the poor in Kenya and around the world. Its focus has shifted from being developmental to emphasizing on being commercially viable businesses through enterprise support.

Until the early 1990s, most Micro Finance Institutions (MFIs) in Kenya did not have to worry about competition, providers sought to reach a huge untapped market. This period of low competition was essential for the development of microfinance as it allowed microfinance institutions to focus single-mindedly on making the breakthroughs in methodology and management necessary to reach sustainability. These breakthroughs have now brought microfinance to the threshold of competition precipitated by the growth of the industry and entrant of new players. MFIs are thus increasingly finding competitors vying for their clients. However the impact of such competition or its nature here of have not been have not been documented.

It is not clear if the MFIs will be able to meet their objectives within the recent competitive environment. The basis on which MFIs compete in Kenya has not been studied and documented.

The government of Kenya having recognized microfinance as a valuable tool to alleviate poverty has enacted a bill to regulate the industry. It is however not clear on the exact nature of competition facing the MFIs in Kenya. For instance the impact of such competition on MFIs ability to meet their objectives has not been documented and neither have the basis on which the MFIs compete been studied. Using Michael Porter's five forces framework what are the specific factors that determine the nature of microfinance industry competition in Kenya? And what is the basis of such competition among the MFIs in Kenya?

1.3 Objectives of the Study

The objectives of this study are:

- (i) To establish the basis of competition faced by the MFIs.
- (ii) To determine the factors shaping competition within the industry using Michael Porter's Five Forces framework.

1.4 Significance of the Study

The findings of this study will be beneficial to the MFI management teams. It will enhance their awareness of the shape of competition affecting their threats and opportunities and be able to make appropriate strategic decision. In addition, the Association of Microfinance Institutions AMFI can use the results of this study to develop appropriate support programs to its members.

The Government of Kenya can also use the results to shed light to the state of competition within the industry that will enable the regulator to adopt the right policy. Researchers & Academicians – the study will inform other studies that may be taken in this area. Microfinance practitioners - The study will benefit all practitioners, who wish to better understand the industry and especially the nature of the competitive environment. This will assist key decision makers in micro finance industry to rethink their strategies as necessary

CHAPTER TWO: LITERATURE REVIEW

2.1 Industry Competition

Industry competition can be analyzed and understood using porters' five forces model.

Competition in an industry depends on the collective strength of five basic forces. The model provides a framework that enables a player to formulate strategies that influence or defend itself against the forces (Porter, 1980). Wheeler and Huger (1990) and Waitaha (2001) argue that porters 5 forces model was developed for a developed country context, which is different from a developing country, however they can be adapted to analyze most industries.

Competition is a dynamic and interactive process with competing organizations constantly seeking advantage in an ever changing environment (Lewis et al. (1999:70).

The purpose therefore, of analyzing the forces shaping competition is to help in formulating appropriate strategies.

Competition has intensified dramatically over the last decade in virtually all parts of the world. Gone are the days of protected markets and dominant market positions. Intensification of competition is attributed mainly to the remarkable post world war two economic progress of Germany and Japan. This increase in competition has played a major role in unleashing innovation and driving progress worldwide (Porter, 1997).

Likewise there are few industries that have not experienced competition. No company and country can ignore the need to compete and each therefore must understand and master competition.

Porter (1980) writes that the essence of strategy formulation is coping with the competition. In the fight for market share competition is not only manifested in other players, but also in customers, suppliers, potential entrants and substitute products. Porter argues that competition in an industry is dependent on the collective strength of the five basic forces.

Porter's five forces model is used at the level of strategic business units (SBU). An SBU is a unit within the general organization for which there is an external market for goods and services distinct from another SBU Johnson and Scholes (1997) it is at this level that strategic decisions concerned with best satisfying customer needs for competitive advantage are made. Any corporate strategist tries to look for a position in the industry where his company can best defend itself from the forces above or to influence them. To do so there is need to understand the underlying sources of competitive pressure. This knowledge provides ground work for a strategic agenda for action. Since barriers to entry differ by industry, product, market, it is important that MFI's establish which barriers exist in their industry. A thorough understanding of the firm's position will lead to formulation of appropriate competitive strategies. Robinson (2001) argues that in the new global economy, the traditional view that executives and managers have the ability to fully grasp the industry's competitive forces is nearly extinct. Competition is simply too quick and unpredictable. He argues that unsuspected new players can change the rule of long established industries. Leaders and managers must therefore be keen on execution of strategy.

The Power of buyers is related and constitutes the firm's value chain. It influences margins and may constrain a firm's strategic freedom. In strategy formulation, the firm needs to understand the extent to which power can be enhanced or mutual interest accommodated in the supplier-buyer channel (Johnson & Scholes, 1997).

A firm must be careful not to limit the scope of substitutes. The threat may take the form of product for product substitution or substitution of need, generic substitution or doing without. Firms need to analyze their products versus substitutes to establish whether they threaten their products or provide a higher perceived benefit or value as well as how easy customers can change to substitutes and how the threat be reduced. Johnson & Scholes (1997) argue that because each industry is unique, different forces take on prominence in shaping competition in each industry. A firm therefore needs to analyze its position in the industry against competition to establish its standing in relation to the forces highlighted above. It may conduct a SWOT analysis in relation to key forces that work in the industry. Through this it is able to determine what needs to be done to influence competitive forces affecting its' business.

Lewis (in Lewis et al, 1999:72) argues that in an "increasingly competitive, business environment" the purpose of strategy is to provide "insights into the fundamental economic and technological characteristics of their industry". Miller & Dess (1996:64) note that the competitive environment "refers to the situation facing an organization within its specific competitive arena". The overriding concern of strategy creation is whether capabilities are being leveraged in ways that provides the business with sustainable sources of competitive advantage.

Lewis et al. (1999:70) notes that "competition is a dynamic and interactive process" with competing organizations constantly seeking advantage in an ever changing environment. The purpose therefore, of analyzing the forces shaping competition is to help in formulating appropriate strategies.

2.2 Five Forces Framework for industry competition.

Porter's 'Five Forces' model is a commonly used analytical tool that attempts to "broaden our thinking about how forces in the competitive environment shape strategies [and] affect performance" (Miller & Dess, 1996:64). The 'Five Forces' model challenges managers to look beyond the rivalry between existing competitors as 'the competition', to include analysis of the threat posed by both new entrants and substitute products on the one hand and the bargaining power of both supplies and customers. These forces determine the nature and extent of competition and shape the strategies of firms in their particular competitive environments.

Figure 1: Porters five forces model



Source: Porter (2004), *Competitive Strategy*, pg. 4

Porter (1980, in Hoskisson 1999) argued competitive advantage is gained by how well organization's positions and differentiate itself, within an industry. The 'Five Forces' embody the rules of competition that determine industry attractiveness and help determine a competitive strategy to "cope with and, ideally, to change those rules in the firm's favor" (Porter, 1985 in Hoskisson, 1999). As a significant contribution to the field of strategic management, Porter's framework specifies the competitive structure of an industry in a more tangible manner.

2.3 Effects of Industry Competition

Industry structure and positioning within the industry are the basis for models of competitive strategy promoted by Michael Porter. The "Five Forces" diagram captures the main idea of Porter's theory of competitive advantage. The Five Forces define the rules of competition in any industry. Competitive strategy must grow out of a sophisticated understanding of the rules of competition that determine an industry's attractiveness. Porter claims, "The ultimate aim of competitive strategy is to cope with and, ideally, to change those rules in the firm's behavior" (1985, p. 4).

The five forces determine industry profitability, and some industries may be more attractive than others. The crucial question in determining profitability is how much value firms can create for their buyers, and how much of this value will be captured or competed away. Industry structure determines who will capture the value. But a firm is not a complete prisoner of industry structure - firms can influence the five forces through their own strategies. The five-force framework highlights what is important, and directs manager's towards those aspects most important to long-term advantage.

Industry structure analysis based on Porter's 'Five Forces' of competition model attempts to quantify the growth and contraction patterns of a market in an attempt to understand the future implication of rivalry among competitors, product substitution and the potential for new entrants with unique offerings (Pettigrew, 1996). For example, Miller & Dess (1996) note that the strategies that are deployed to address the threat of new entrants may focus on widening the barriers to entry, by exploiting economies of scale, product differentiation, and market dominance to aggressively challenge incumbents.

The customer may exert considerable bargaining power and force price concessions where high-volume purchases are made or where either, backward integration and product substitution is possible. Manufacturers for example, may adopt strategies to address the bargaining power of large retailers including, consolidating with other manufacturers to create a collective bargaining position or alternatively, product differentiation strategies that distance the organization from competitors. However, Browne et al. (1998) argue that the bargaining power of customers is not independent of the other elements of the 'Five Forces' model and is in turn, "influenced by the extent of choice available to them through rivalry in the market and the possibility of substitution" or the effect of new entrants.

The bargaining power of suppliers is an important consideration within an industry because of the direct impact on the costs of inputs and therefore profitability. Strategies to address the bargaining power of suppliers in industries where supply costs constitute a high proportion of the total cost and where there is dominance by a few suppliers and a lack of substitute products are harder to define. Typically organizations require a large

number of inputs, from financial equity to stationary, on a variety of terms from cash to long-term contracts. Given the larger number of suppliers and the variety of exchange relations, analyzing the 'bargaining power of suppliers' may be particularly complex. Focusing on suppliers of strategic importance (i.e. a supplier of an essential raw material that is difficult to source) is more likely to isolate suppliers who are able to exert bargaining power.

In advocating the 'Five Force' model, Miller & Dess (1996:71) argue that the strategist must first "determine whether it is better applied to the broader industry as a whole or to a strategic group within the industry". Miller & Dess (1996:71) define 'strategic groups' as "clusters of competitors that share similar strategies" and compete at a conceptual level rather than within a specific industry. For example, a manufacture may produce the majority of its product for the consumer market with competitiveness deriving primarily from cost control, while simultaneously competing in a smaller luxury market where the best strategy is product differentiation through superior quality and features.

Browne et al. (1998) argues that Porter's Industry analysis is based primarily on the implicit notion that "industries consist of a set of vertically related markets". Porter's model is by necessity, a simplistic and stylized diagrammatic representation in which the organization is depicted as being engaged in exchange relationships with downstream customers and suppliers and in competition with new entrants and the threat of substitutes, which together "influence the dynamics of competition and the distribution of bargaining power" (Browne et al., 1998:35). It is difficult to apply Porter's model to large

multi-divisional organizations that integrate successive stage of production or amongst organizations that have created a long-term preferred supplier relationship.

Browne et al. (1998:29) argue that opportunities exist to improve organizations profit by “considering alternate ways by which production and service delivery is organized”. For example, vertical integration may yield greater control over the supply of materials (backward integration) or delivery logistics (forward integration). Similarly, long-term symbiotic preferred supplier relationships between independent organizations offer greater security and quality than a lowest-cost approach might deliver.

According to Lewis et al. (1999:57), an important change in the study of strategic management has been the “application of rigorous analysis based on concepts and tools from economics”. They add that the “point of strategic analysis is to understand the basic economic and technological characteristics of their industries”. However, Lewis notes “an unfortunate tendency” for strategic analysis using models such as Porter’s ‘Five Forces’, to degenerate into a simplistic checklist of factors that fail to develop a deep or intrinsic understanding (Lewis et al. 1999:81).

More recently, a ‘resource based view’ of strategic management suggests that the organization is composed of distinctive resources and capabilities that is inextricably linked with the market demands of the external environment.

2.4 Effects of Competition in the MFI Industry

Graham & Rippey (2003) contend that increasingly competitive and varied marketplace is beginning to be reflected in a growing number of countries worldwide. The recent years have seen competition amongst MFIs growing in many marketplaces round the world, with Bangladesh, Bolivia and Uganda acknowledged to have particularly competitive environments. These market places offer an opportunity to learn about the effects of competition on microfinance institutions and their clients.

In a competitive environment, microfinance institutions must shift their thinking to respond to different challenges as outlined in the table:

Table 2: Concerns of MFIs before and during competition

Pre-Competitive Stage	Competitive Stage
Objective: to reach more people and to become financially viable	Objective: to retain or increase market share, while remaining profitable
Internal focus: developing the institution's internal capabilities	Internal issues remain important, but external focus is added: understanding the external environment and incorporating that understanding into business strategy
Driving motivation: access to funding	Driving motivation: attracting and retaining the customer
High growth possible. Some MFIs have doubled their portfolio annually for several successive years with no competition and abundant donor funds.	Low growth, stagnation, or even portfolio shrinkage possible, even for large well-managed MFIs, as the experience in Bolivia shows.
Little need to take the behaviour of other players into account	Must study the behaviour of the clients, prospective clients, and competitors, or suffer grave consequences.
Client demand taken as given. Institutions can grow and be profitable with unchanging, unpopular products.	Client demand can evaporate quickly if competitor provides better service. Institutions that think strategically, satisfy customers' needs and desires, and innovate intelligently are likely to do well; others are likely to have hard times.

Adapted from Rhyne and Rothbalt (1997): What Makes Them Tick? Exploring the Anatomy of Microfinance Organizations, page 202.

Using the above table to analyze Uganda market Graham & Rippey (2003) concluded that it was reasonably clear that, in parts of Uganda, the “competitive stage” has been

underway for several years now. The implications for MFIs and indeed their clients are significant Uganda.

The (typically) salary-based lending new entrants and apparent high levels of multiple membership has lead to fears that Ugandan MFI clients might be increasingly over indebted In Bolivia, "The momentum of lending growth that propelled both the microfinance institutions and consumer lenders created a bidding war, with competitors vying for clients by offering larger loans, faster service, and lower interest rates. This momentum inflated the total amount of debt on the informal streets of the country. Once the economy stalled, it quickly became evident that thousands of clients held more debt than their reduced level of economic activities would allow them to service. Over indebtedness was rampant, particularly common among the high proportion of clients who had borrowed from multiple micro lenders at the same time" (Rhyne, 2002).

But, as experience in Bangladesh shows, there are different drivers of over indebtedness. "It appears that for deficit households, distress management is the reason for multiple borrowing, while for better off households multiple borrowing is mostly opportunity driven. The main supply-side challenge is that the lending technology fails to distinguish between the two types of clients, and offers uniform products" (Chaudhury and Matin, 2002). This has significant implications for the industry's response to over indebtedness. "Multiple-membership calls not only for creating arrangements such as credit bureaus, but also for more concrete advances in providing protective financial services while diversifying the range of promotional ones. In this sense, it is an opportunity as much as a challenge" (Chaudhury and Matin, 2002).

MFIs are a new breed of organizations and limited research has been undertaken to find out what their practices are in strategic management. But even more specifically, how they are coping with competition in their environments. Some of the strategic issues identified by several research studies include addressing the needs of clients, cost efficiency in service delivery, alternative and improved choice of products and services, and financial self-sufficiency. Many of these studies undertaken tend to focus on challenges of MFIs from an inside view, e.g. issues of high cost of service delivery, and limited capacity and risks (Ananth and George, 2003). But it is possible that these internal challenges continue to exist because little attention is being paid to the forces operating in the environment e.g. evolving increased client knowledge, competition, and new sources of funding, among other things.

Some crucial industry changes are well documented e.g. the changing funding environment “the emerging wisdom on the need to balance financial support with business development for successful crusade against poverty” (Oketch, 2001). The writer alludes to the tensions existing between the need for change in funding sources and the need for MFIs to retain their original mission of serving the poor. Very little is mentioned on how MFIs are managing these tensions. The writer admits that to manage these tension the MFIs should first focus on development objective, and this way it will be easier to pursue the objective of sustainability. To do this requires strategic leadership. The strategy is to focus on building people first.

There is need for MFIs to lobby and challenge the government and Central Bank to put in place policies that will support the growth of the industry Fowler and Kinyanjui (2004).

The other viable option was adopted by KREP bank is raising funds through equity this option however requires a high level of institutional capacity that may be lacking in many other MFIs. This increasingly competitive and varied marketplace is beginning to be reflected in a growing number of towns in Kenya. This represents an important change, since until the late 1990's, most MFIs did not have to worry about competition

There is rising need for MFIs to pay more attention to the external environment, especially to the clients and competitors. This will require new skill in market research, which was previously not critical for businesses in many MFIs. Studies in the area of competition tend to dwell on how MFIs will be affected by this factor, i.e. competition.

The studies do not however offer useful suggestion on how competition could be dealt with. There has been a drive to introduce regulation into microfinance in order to streamline the industry, but more specifically regulation is meant to protect the solvency of MFIs which is two fold: stability of payment and deposit protection. Drake Rhyne (2002). It is also being argued that regulation will test MFI ability to survive in the long term but importantly they will be able to identify their weaknesses opportunities, and in this way they will be able to develop appropriate strategies. The MFIs are faced with choices of which regulatory frame work to adopt in order to satisfy there vision. This takes discussion back to commercialization where MFI may transform into commercial banks the way K-REP did while other may seek registration as specialized financial institutions under a new microfinance law.

Given these myriads of strategic issues facing MFI the need for analyzing factors shaping competition cannot be over emphasized. Understanding the basis on which MFIs compete in an increasingly competitive environment is fundamental to the survival. Understanding the factors shaping competition in the industry will facilitate pursuit of clear strategies that will bring about innovative and dynamic MFIs. In this way they will be able to pursue superior growth that may be evidenced by financial strength deepened outreach and consistent innovation (Ewing, 2004)

2.5 Summary

From the literature review and personal experience the researcher would want to argue that the structure of competition is not well known neither are the inherent factors shaping it within this new exciting industry. Many MFIs are finding themselves faced with competition from more stable institutions with heavy advertising budgets like commercial banks. The actions of many MFIs are still influenced by the donors who have put money for specific objectives like lending to some economically challenged areas which are not necessarily financially viable. With donors dictating different things like who should be served, and keenness on smaller loans sizes MFIs face serious challenges on how to handle competition. The forthcoming implementation of regulation based on the new microfinance law will put pressure on MFIs to financially viable and definitely weak MFIs may not survive. In its original form, micro-finance business was considered as 'charity.' As a result, the performance of the schemes was characterized by affected by very good loan recovery, inefficiency and high management costs which consequently led to underperformance or collapse.

However, over the past decade the industry has transformed into a large, dynamic private sector catering for the financial needs of the low -income households and economically active poor. Over the years, the MFIs have demonstrated considerable comparative advantage in their service provision to rural and low-income urban clients. Furthermore, most institutions have embraced a more business oriented outlook and maintaining their target groups of economically active poor while focusing on achieving operational and financial sustainability.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Research design

This study used a descriptive survey design to identify the basis on which MFIs compete and the nature of competition within the industry. Mugenda and Mugenda (1999) notes that a descriptive research attempts to collect data from members of a population and helps researcher get a description of the variables. This research design is relevant to this study because the researcher has information on the forces determining the nature of competition in an industry and would like to apply it to microfinance industry in Kenya.

3.2 The Population

The population was all the 18 MFIs in Kenya that were members of the Association of Micro Finance Institutions (AMFI) as at 2007 (AMFI, 2006). This is because AMFI membership is fully representative of the Kenyan microfinance industry and member MFIs share a vision of reaching the majority of the population not in formal banking and are committed to availing a wide range of financial products and services to the poor and low income earners (usaidkenya.org, 2007). Due to the low target population, the researcher set out to conduct a census survey involving all the registered members of AMFI. However, data were collected from a total of 12 institutions implying a response rate of 66.7%. The imperfect questionnaire return rate was mainly because some institutions could not return the completed tool on time.

3.3 Data collection

Emphasis was given to both primary and secondary data. In this study a semi-structured questionnaire was used and quantitative data on the respondents' perception to competition were obtained. Mugenda and Mugenda, (1999) suggests that structured questions are easier to analyze since they are in immediate usable form. Unstructured questions on the other hand permit a greater depth of the response. The questionnaires were designed and personally administered to chief executive officers of the MFIs registered under AMFI.

For the secondary data documents, sources were employed where by use of previous documents or materials to support the data received from questionnaires and information from interviews that include book and magazines available in the libraries which were visited as well as information from relevant websites. The MFIs financial reports, management circulars and minutes to their meetings were other sources of secondary data.

The questionnaire is divided into three parts. These include:

Part A: The profile of the organization which focuses on the generic details of the organization.

Part B: The basis on which the MFI competes with others

And **Part C** covers the competitive environment of the MFI, the current state of business and the sources of competitive pressures: the questions in this section will draw out the competitive factors affecting the organization.

3.4 Data analysis

Data collected was analyzed based on primary statistics. The collected data was coded and entered in the Statistical Package for the Social Sciences (SPSS) in which analysis will be conducted. Measures of central tendency were used to give expected summary statistics of variables being studied while standard deviation was used to show the variability. Frequency distribution charts, percentages, relationships of parameters and cross tabulations were computed to make inferences.

CHAPTER FOUR: RESEARCH FINDINGS AND INTERPRETATION

4.1 Profile of Respondent Firms

The section presents the research findings of a study carried out to investigate the nature of competition in the micro finance industry. In this section the background characteristics of the respondents are provided. These include: Experience in industry, number of employees, profile of customers served as well as the financial products offered.

4.1.1 Duration in MFI service provision

The study sought to establish the duration that the MFIs had been involved in the provision of the services. A longer duration of operation implies more exposure and a likelihood of having lived through various phases of competition.

Table 3: Years in operation

	Frequency	Percent
1-5	2	16.7
6-10	3	25.0
Over 10yrs	7	58.3
Total	12	100.0

Source: Research Data

Table 4.1 shows that majority of the MFIs (58.3%) had an experience in the industry exceeding 10 years indicating that these are among the pioneer institutions that have shaped the MFI industry to what it is in Kenya today. Only 16.7% of the firms had an experience of less than 5 years.

4.1.2 Size

Shown in Table 4.2 below is the number of employees in these institutions.

Table 4: Number of employees

	Frequency	Percent
10 and below	1	8.3
Between 11 and 50	2	16.7
Above 51	9	75.0
Total	12	100.0

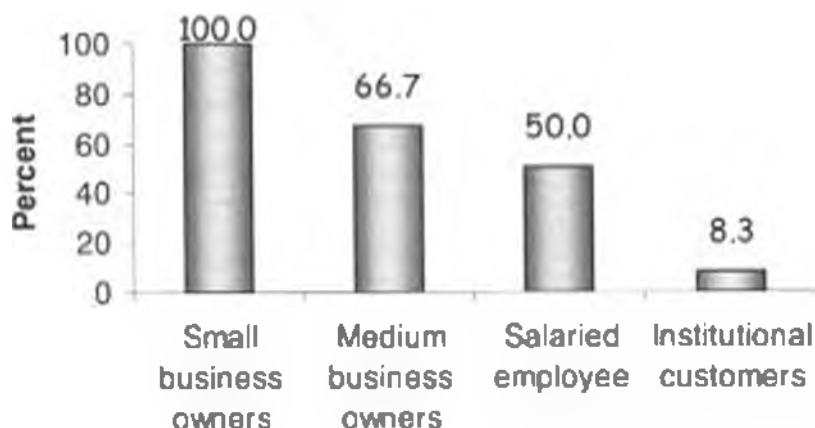
Source: Research Data

As shown in Table 4.2, majority (75%) of the MFIs had a staff size exceeding 51 while 16.7% had a number of employees ranging between 11-50. The findings show that many of the MFIs involved a relatively large number employees and this is most likely because they dealt with large numbers of customers.

4.1.3 Target Markets

It was deemed necessary to understand the MFIs target customers to establish the existence of market segmentation that could diffuse competition within the industry. The study findings in this regard are shown in Figure 4.1.

Figure 2: Profile of target customers



Source: Research Data

Figure 1 illustrates that all the MFIs targeted small business owners as customers. These category of customers seem to form the core clientele of most MFIs implying that the institutions were most likely to jostle for attention of small business owners. It can also be seen that two thirds of the companies surveyed reported to target medium sized businesses as customers while 50% targeted salaried employees. These findings suggest that MFIs were likely to minimize the effects of competition by reaching out to a wider classification of customers.

The findings also indicate that some MFIs had products targeting to attract the institutional customers. While this deviates from tradition whereby MFI exclusively served the small scale entrepreneurs, it may be indicative of a trend in which such institutions encroached the territory of mainstream financial institutions with products targeting institutional customers. At this stage, the extent to which competition in the industry could have given rise to the foregoing trend is not clear.

4.1.4 Financial products offered

The range of products offered by the MFIs was also investigated and is as shown in Table 3 below.

Table 5: Company Ownership

Users ownership	Frequency	% with the product
Business loans	11	91.7
School fees loans	10	83.3
Savings	10	83.3
Consumption/household	9	75.0
Emergency loans	9	75.0
Micro Insurance covers	8	66.7
NSE shares loans	6	50.0
Youth Loans	2	16.7
Business training	1	8.3
Agricultural loans	1	8.3

Source: Research Data

As shown above, business loans were the most common product offered by a majority of the MFIs (91.7%). Savings products and school fees loans were also among the most popular products found to be rolled out by 83.3% of the institutions surveyed. It may also follow that competition in the industry may concentrate around these products by virtue of existence of several providers of the same.

Conversely, the fact that there were many players offering business loans, school fees and savings products implies that customers had access to a wide variety of substitutes within these range of products. This indicates that the threat of substitutes as a force of competition is likely to be centered around these products.

Table 3 also shows that 8.3% offered business loans as products and a similar proportion offered agricultural loans. This shows that there were some players offering unique products targeting a segmented market.

4.2 Basis of Competition

Competition in the MFI industry can take many forms as the players implement strategies to win the customers. The basis of the competition encompasses the aspects such as pricing and target market for which industry players fight out for a market niche. One of the study objectives therefore was to establish the basis of the competition within the microfinance industry. The respondents were asked to describe the intensity of the competition within the industry over the last three years and the following findings were obtained.

Table 6: Intensity of competition faced over the last 3 yrs

	Frequency	Percent
Moderately increased	6	50.0
Rapidly increased	6	50.0
Total	12	100.0

Source: Research Data

As evidenced in Table 4.4, 50% of the respondents indicated that the competition had moderately increased while the rest said it had rapidly increased. It is clear that competition within the industry had taken an increasing trend in the period preceding the study.

Asked to enumerate the main competitors, the respondents gave the findings shown in Table 5 below.

Table 7: Main competitors as perceived by MFIs

	Frequency	Percent
Other microfinance institutions	12	28.6
Savings and credit organization SACCOS	9	21.4
Commercial banks	8	19.0
Informal groupings e.g. merry go round	6	14.3
Rotating savings and credit organization	5	11.9
Kenya Post Office Savings Bank	2	4.8
Total responses	42	100

Source: Research Data

As shown above, majority (28.6%) of the responses obtained indicated that other micro finance institutions gave them competition, while 21.4% cited competition from savings and credit organizations commonly referred to as SACCOs. It is plausible that MFIs perceived other institutions offering products in a setup akin to their own were perceived to be most serious competitors.

Interestingly, one half of the MFIs or 14.3% of the responses perceived informal groupings such as 'merry-go-rounds' to be competitors while the Kenya Post Office Savings Bank (Post Bank) was least regarded as a competitor. The latter is mandated to offer exclusively savings products. This implies that MFIs regarded a competitor most seriously when they offered credit facilities as opposed to savings products.

The respondents were asked to rank the factors affecting competition within the microfinance industry on scale of 1-5 where 5 signified very high. Table 4.6 below

illustrates the findings by showing the proportion of respondents that gave a high or very high rating.

Table 8: Ranking of factors influencing competition

	N	Mean	Std. Deviation
Other MFIs offering products/services	12	4.25	1.055
Substitutes products/services from commercial banks	12	3.50	1.087
Lack of entry barriers	12	3.33	1.303
New entrants to microfinance business	12	3.17	1.030
bargaining power of financiers/donors	11	3.09	1.136
Ease of entry and exit from industry by MFIs	11	2.82	1.168

Source: Research Data

According to Figure 4.2, other MFIs offering the same products and services (mean=4.25) were reported to most highly influence the competition within the micro finance industry. This finding reiterates that given earlier that the greatest competition force emanated from other players in the industry offering similar/substitute products.

Substitute products offered by commercial banks were said to highly influence competition as indicated by mean = 3.5. This finding confirms the market observation where banks have in the recent past aggressively come out with products targeting individual and small businesses.

A factor considered to least influence the competition was found to be ease of entry into the MFI industry (mean=2.82). This suggests that industry players did not regard potential entrants into the industry as influencing competition relative to other factors.

4.3 Factors shaping competition within the industry

According to Porter's (1980) five forces framework, there are five principal forces that determine industry competition. These are: the threat of new entrants, the threat of substitution, the bargaining power of buyers, the bargaining power of suppliers and, finally, the rivalry amongst existing competition in the industry. The study objective therefore was to investigate the factors shaping the competition within the MFI sector in light of Michael Porter's Five Forces framework.

4.3.1 Threat of New Entrants as a Force of Competition

The respondents were asked to state whether new entrants into the industry affected the competition they faced. The findings obtained are as shown in Figure 4.2 below.

Figure 3: Responses to whether new entrants affect the competition



Source: Research Data

As illustrated above, majority of the respondents (83%) reported that new entrants affected competition within the industry while 17% held a divergent view. Asked to state the extent to which new entrants affected competition, 75% stated that it greatly/slightly affected while 25% stated that such effects were modest. (Table 4.7)

Table 9: Extent to which new entrants affect competition

	Frequency	Percent
Slightly affects	3	25.0
Affects	7	58.3
Greatly affects	2	16.7
Total	12	100.0

Source: Research Data

The respondents were then asked to rank the factors according to how they perceived them to facilitate the new entrants into the microfinance industry. The findings obtained are as shown in Table 4.8 below.

Table 10: Ranking of factors perceived to facilitate new entrants into the industry

	N	Mean	Standard dev.
Accessibility of lending methodologies	12	4.33	0.778
Ease of creating an MFI	12	3.83	0.835
Attractive industry draws new players	12	3.58	1.084
Start - up donor funding available	12	3.25	1.603
Diversity of clients	1	5.00	-
Industry demand	1	4.00	-

Source: Research Data

Accessibility of lending methodologies (mean=4.33) and the ease of creating a micro finance institution (mean=3.83) were regarded by respondents to be factors that most facilitated the entry of new players into the MFI industry. The low standard deviations imply high consensus among the respondents on the same.

Attractiveness of the industry (mean=3.58) was reported to attract new players. This indicates that the demand and supply laws played a role in propelling other players to join the industry. The same are likely to prompt the exit of other players who may not get a sustainable market share.

A fringe reason given by a single respondent was the diversity of clients. This suggests that some players set foot into the MFI industry to serve a special need that they deem to be unmet by other players. While this depicts ingenuity it has to be backed up by well done prospecting or market research to determine its sustainability.

4.3.2 Threat of Substitutes as a Force of Competition

Threat of substitutes as a force of competition in the micro finance industry was investigated. The respondents were asked whether they perceived competition by virtue of existence of other products that could act as substitutes. Findings are as shown below.

Table 11: Accessibility to substitutes products/services to customers

	Frequency	Percent
Yes	9	75.0
No	1	8.3
Not sure	2	16.7
Total	12	100.0

Source: Research Data

According to Table 4.9, majority of the respondents indicated that their customers had access to that could serve as substitutes. Those that thought their products were unique were 8.3% while 16.7% were not sure. The respondents' opinion on the extent to which substitutes contributed to competition is as shown in Table 4.10.

Table 12: Extent of substitutes contributing to competition

	Frequency	Percent
Not sure	1	8.3
Moderately	1	8.3
High	4	33.3
Very highly	6	50.0
Total	12	100.0

Source: Research Data

Majority of the respondents (83.3%) reiterated that substitutes high/very highly contributed to the competition. This clearly demonstrates that the threat of substitutes was perceived to be a major force of competition in the MFI industry. The respondents were then required to rank the products and services according to how they were perceived to be available to their customers as substitutes. Table 4.11 shows the results.

Table 13: Extent of customer access to substitutes

	N	Mean	Std. Deviation
SACCOS	11	3.73	1.497
Roscas/informal savings mechanisms	12	3.67	1.595
Money lenders	12	3.67	1.079
Savings	12	3.33	0.985
Commercial banks	12	3.17	1.155
Supplier credit	11	2.82	1.044
Credit cards	10	2.10	1.193
Micro insurance	11	2.09	1.272

Source: Research Data

As seen in Table 4.11 SACCOS (mean=3.73) and Roscas/informal savings mechanisms (mean= 3.67) were perceived to be the substitutes MFI customers had most access to. The high standard deviation however indicates that there was least consensus among the respondents on the same. This is probably because the threat of substitutes is specific to the range of products offered by a particular MFI.

Commercial banks (mean=3.17) and customers own savings (mean=3.33) were moderately ranked as substitutes by the respondents. The recent moves by the mainstream banking sector to increasingly target the small customers may be a factor contributing to the ranking.

In the face of the substitute products that customers were perceived to have access to, MFIs may need to package their products to stand out so as to attract more customers. It may also be necessary to create lasting relationships with customers that would ensure they continue to access their products even when they have alternatives from other institutions such as commercial banks.

4.4.3 Bargaining Power of Financial Suppliers as a Force of Competition

The study also investigated bargaining power of financial suppliers as a force of competition. Respondents were asked if they thought financial suppliers in the MFI industry had bargaining power and the responses in Table 4.12 were obtained

Table 13: Responses to whether financial suppliers in MFI industry have bargaining power

	Frequency	Percent
Yes	7	58.3
No	4	33.3
Not sure	1	8.3
Total	12	100.0

Source: Research Data

As shown above, majority of the respondents (58.3%) indicated that the financial suppliers had bargaining power while 33.3% responded to the contrary. The extent of such influence was investigated to yield the responses shown below.

Table 14: Extent to which bargaining power of financial suppliers affect competition

	Frequency	Percent
None/Very low	1	8.3
Low	1	8.3
High	8	66.7
Very high	2	16.7
Total	12	100.0

Source: Research Data

Majority of the respondents indicated that financial suppliers' bargaining power could highly or very highly affect the competition in the industry. The factors that influenced competition are as shown in table 4.14 below.

Table 15: Extent of factors affecting bargaining power of financial suppliers

	N	Mean	Std. Deviation
Importance of donors in local industry	12	3.75	1.422
Ease of getting capital from commercial sources	12	3.58	0.900
Current health of financial system and liquidity conditions	12	3.58	1.165
Ease of getting access to capital from donors	12	3.42	1.379
Existence of loan guarantees and other mechanisms to facilitate linkages with formal financial sector	12	2.83	1.586
Kenya's MFI's credit rating	12	2.17	1.115

Source: Research Data

Importance of donors in local industry (mean=3.75) ranked highly as a factor affecting the bargaining power of financial suppliers. This probably reflects the influential role played by donors in the MFI sector. It implies that the financial suppliers bargain is affected by whether or not they have access to donor funding.

Ease of getting capital from commercial sources (mean=3.58) and Current health of financial system and liquidity conditions (mean=3.58). Apparently availability and ease of accessing capital were not seen to erode the bargaining power of financial suppliers but were instead reported to highly affect the bargaining power. There was highest

consensus among respondents on ease of getting capital from commercial sources as indicated by a standard deviation of 0.9

4.4.4 Bargaining Power of Customers as a Force of Competition

The study also investigated the bargaining power of competition as a force of competition within the micro finance industry. The respondents were required to rank the effect of the aspects provided and the results are as shown in Table 4.15 below.

Table 16: Basis of bargaining power of customers

	N	Mean	Std. Deviation
Existence of viable alternate providers	11	3.91	0.944
Price sensitivity of customers	11	3.82	1.537
Level of awareness of other providers	11	3.45	1.293
Number of potential customers relative to providers	11	3.36	1.362
Level of knowledge of customers	12	3.25	1.357
Difficult of switching from one MFI to another	12	2.25	1.055

Source: Research Data

Table 4.15 shows that existence of viable alternate providers (mean=3.91) was identified by respondents as the most likely basis for customers bargaining power. The relatively low standard deviation also indicates a high consensus. This shows that the MFI players reckoned that customers would bargain more if they had alternatives.

Difficult of switching from one MFI to another (mean =2.25) was identified as the least influential factor on the customers bargaining power. This implies that the MFI providers

did not consider their customer as too attached to them to the extent of not seeking alternative providers.

4.4.5 Rivalry among existing competitors as a Force of Competition

The extent of rivalry among the existing competitors contributing to competition was investigated from which the findings in Table 4.16 were obtained.

Table 17: Rivalry among existing competitors

	N	Mean	Std. Deviation
Degree of market penetration by other providers	12	3.58	1.165
Number of other MF providers	12	3.50	0.798
Presence of non-traditional providers eg banks, cooperatives	12	3.33	1.497
Stage of industry growth	12	2.75	0.866
Level of skill and development of other providers	12	2.67	0.778

Source: Research Data

According to findings in Table 4.16 above, degree of market penetration by other providers (mean=3.58) and number of other MF providers (mean =3.5) were highest ranked as a factors shaping the rivalry between the existing competitors. This suggests that MFI players may compete against each other based on how long they have been in the industry.

Presence of non-traditional providers e.g. banks, cooperatives (mean=3.33) was moderately ranked as an avenue through by which the rivalry leading to competition was

staged. The high standard deviation however depicts a lack of consensus among the respondents implying competition with other players were perceived differently by different MFI providers.

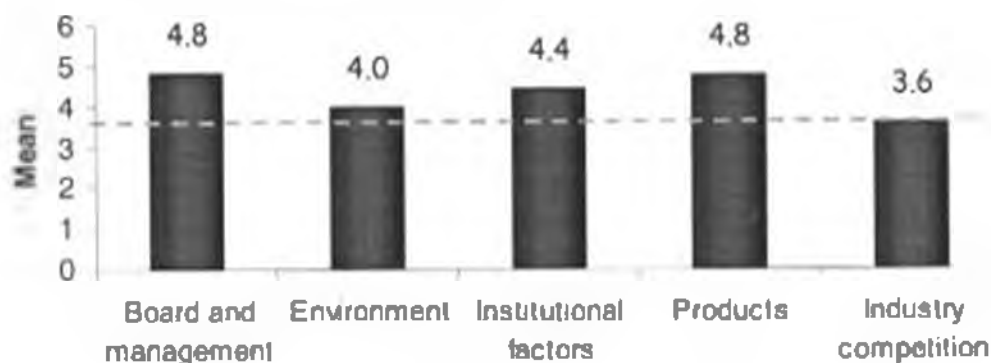
To cap it up the study inquired into other broad factors that could affect the success of an MFI in Kenya. The findings are as shown in Table 4.17 and Figure 4.4 below.

Table 18: Extent of customer access to substitutes

	N	Mean	Std. Deviation
Free hand in decision making	12	4.83	.389
Policy environment; regulatory environment	12	4.00	.853
Bank structure, access to underserved market, costs, training and personnel	12	4.42	.793
Careful product design, agile loan process, portfolio quality and marketing	12	4.75	.452
Competition from other institution; MFIs, banking institutions, SACCOS	12	3.58	.900

Source: Research Data

Figure 4: Extent of customer access to substitutes



Scale: 5 – highest 1- lowest

As shown above respondents identified the management of an MFI and the range of products offered as the factors with the highest impact on the chances of success of a microfinance institution. This highly suggests that upon inception, internal factors that include the quality of management and the range of products on offer had a very high influence on the chances of success of an MFI institution.

It can be seen clearly that industry competition was ranked lowest in terms of influence on the chances of success of a micro finance institution. It is therefore plausible that most players in the industry may not acknowledge the effect of competition and may thus be less motivated to initiate strategies to beat the competition to gain the pole position in the industry.

CHAPTER FIVE: SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS

5.1 Summary of findings

This chapter gives a summary of the study findings. It also bears the recommendations, conclusion and areas for further research. The broad objective was to investigate the nature and basis of competition within the microfinance industry in Kenya.

The main findings obtained from the study are summarized as follows: -

It was established that the small business owners formed the core clientele of most MFIs implying that the institutions were most likely to jostle for attention of small business owners. Two thirds of the companies surveyed reported to target medium sized businesses as customers while 50% targeted salaried employees. These findings suggest that MFIs were likely to minimize the effects of competition by reaching out to a wider classification of customers.

Some MFIs had products targeting to attract the institutional customers. While this deviates from tradition whereby MFI exclusively served the small scale entrepreneurs, it may be indicative of a trend in which such institution encroached the territory of mainstream financial institutions with products targeting institutional customers. At this stage, the extent to which competition in the industry could have given rise to the foregoing trend is not clear.

Business loans were the most common product offered by a majority of the MFIs (91.7%). Savings products and school fees loans were also among the most popular products found to be rolled out by 83.3% of the institutions surveyed.

One half of the respondents (50%) indicated that industry competition had moderately increased or rapidly increased (50%) in the three year period preceding the study.

All the respondents indicated that other micro finance institutions gave them competition, while 75% faced competition from savings and credit organizations commonly referred to as SACCOs. It is plausible that MFIs perceived other institutions offering products in a setup akin to their own were perceived to be most serious competitors.

Interestingly, one half of the MFIs perceived informal groupings such as 'merry-go-rounds' to be competitors while the Kenya Post Office Savings Bank (Post Bank) was least regarded as a competitor. The latter is mandated to offer exclusively savings products. This implies that MFIs regarded a competitor most seriously when they offered credit facilities as opposed to savings.

Other MFIs offering the same products and services (75%) were reported to highly/very highly influence the competition within the micro finance industry. This finding reiterates that given earlier that the greatest competition force emanated from other players in the industry offering similar/substitute products.

Substitute products offered by commercial banks were said to highly influence competition according to 58.3% of the respondents. These findings confirm the market

observation where banks have in the recent past aggressively come out with products targeting individual and small businesses.

Majority of the respondents (58.3%) indicated that the financial suppliers had a bargaining power while 33.3% responded to the contrary. Ease of getting capital from commercial sources (66.7%) and Current health of financial system and liquidity conditions (66.7%). Apparently availability and ease of accessing capital were not seen to erode the bargaining power of financial suppliers but were instead reported to highly affect the bargaining power.

It was found out 66.7% of the respondents felt that existence of viable alternate providers was identified by as the most likely basis for customers bargaining power. Further, banks, cooperatives (58.3%) were said to be the main avenue through which the rivalry leading to competition was staged.

Respondents identified the management of an MFI and the range of products offered as the factors with the highest impact on the chances of success of a microfinance institution. This highly suggests that upon inception, internal factors that include the quality of management and the range of products on offer had a very high influence on the chances of success of an MFI institution.

5.2 Conclusion

The study investigated the competition within the MFI industry on the basis of Porters; Five Forces Model. Indeed competition as experienced by the players was reported to

exist in all the fronts modeled by Porter. MFIs however did not give due credence to impact competition on their chances of success relative to other factors.

5.3 Recommendations

Following the study findings, the following are the recommendations made.

- It was found out that Informal savings mechanisms (66.7%) and SACCOs (66.7%) were perceived to substitutes MFI customers had most access to. It is recommended that MFIs adopt strategies for creating lasting relationships with customers that would ensure they continue to access their products even when they have alternatives from other institutions such as commercial banks.
- Some MFIs were found to have created products that targeted a highly segmented market such as agricultural loans. It is recommended that MFIs pay attention to product development. This can be achieved through proper market prospecting and market research.

5.4 Areas for Further Research

It was established that MFI players reckoned that customers bargaining power was based on availability of alternatives. Further research should be conducted to determine whether MFI providers knowingly or otherwise portrayed cartel like tendencies especially when pricing their products.

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APPENDIX: QUESTIONNAIRE

**QUESTIONNAIRE ON THE FACTORS SHAPING COMPETITION WITHIN
MICRO FINANCE INDUSTRY AND THE COPING STRATEGIES ADAPTED
BY MICRO FINANCE INSTITUTIONS IN KENYA**

PART A: Background information

- (a) Name of organization
- (b) Position in the Organization
- (c) Over what duration has this organization been offering MF services? (Tick appropriately)
[...] 1-5 [...] 6-10 [...] Over 10 years
- (d) How many employees does your organization have?
 - i) 10 and Below ii) Between 11 and 50 iii) Above 51
- (e) What is occupational profile of your target customers? (Tick all that apply)
 - Small business owners | |
 - Medium business owners | |
 - Salaried employees | |
 - Institutional customers | |
- 2 What financial products do you offer to your customers? (Tick all that apply or attach prospectus if available)
 - Business loans | |
 - Consumption/household loans | |
 - Emergency loans | |
 - School fees loans | |
 - Savings (compulsory/ voluntary) | |
 - NSE shares loans | |
 - Micro Insurance covers | |
 - Any other

PART B

1. Basis of competition

3 How would you describe intensity of competition your institution has faced over the last 3 years? (Tick one)

- a) Has declined
- b) Remained the same
- c) Moderately increased
- d) Rapidly Increased

3 Who are your main competitors? Tick appropriately.

- a) Other microfinance institutions
- b) Commercial Banks
- c) Savings and credit organization SACCOs
- b) Informal grouping e.g. Merry-go round
- d) Kenya Post Office Savings Bank
- e) Rotating savings and credit organization ROSCAS

Any others _____

5 Rank the following factors in order of how you consider them to influence competition within microfinance industry. On a scale of 1-5 (where 5 - Very high 4- High 3 - Moderate 2 - Low and 1- Very low/none)

	1	2	3	4	5
Other MFIs offering similar products /services					
Substitute products /services from commercial banks					
New entrants to microfinance business					
Lack of entry barriers					
Bargaining power of more knowledgeable clients					
Bargaining power of financiers/ donors					
Ease of entry and exit from industry by MFIs					
Other					

PART C: Forces of competition

1. Threat of New Entrants

- 6 Do you think that new entrants into the industry affects the competition you face?
 Yes No Not sure
- 7 To what extent does new entrants affect the competition?
05 Greatly Affects 04 Affects 03 slightly affects 02 Does not affect
01 Not sure
- 8 To what level do the following factors facilitate New Entrants to the microfinance business? On a scale of 1–5 (where 5 - Very high 4- High 3 - Moderate 2 - Low and 1- Very low/none)
- | | | | | | |
|---|-------|-------|-------|-------|-------|
| a) Accessibility of lending methodologies | 1 [] | 2 [] | 3 [] | 4 [] | 5 [] |
| b) Ease of creating an MFI | 1 [] | 2 [] | 3 [] | 4 [] | 5 [] |
| c) Start-up donor funding available | 1 [] | 2 [] | 3 [] | 4 [] | 5 [] |
| d) Attractive industry draws new players | 1 [] | 2 [] | 3 [] | 4 [] | 5 [] |
| e) Any other. | 1 [] | 2 [] | 3 [] | 4 [] | 5 [] |

2. Threat of substitutes

- 9 Do you think your customers have access other products that can serve as substitutes to your products /services?
 Yes No Not sure
- 10 To what extent do substitutes to your products /services contribute to the competition you face?
05 Greatly Affects 04 Affects 03 slightly affects 02 Does not affect
01 Not sure
- 11 To what extent do your customers have access to the following as substitutes to your products /services in order of ranking (1–5) (where 5 - Very high 4- High 3 - Moderate 2 – Low and 1- Very low/none) Tick appropriately
- | | | | | | |
|--|-------|-------|-------|-------|-------|
| a) Roscas or other informal savings mechanisms | 1 [] | 2 [] | 3 [] | 4 [] | 5 [] |
| b) Supplier credit | 1 [] | 2 [] | 3 [] | 4 [] | 5 [] |
| c) Credit cards | 1 [] | 2 [] | 3 [] | 4 [] | 5 [] |
| d) Moneylenders | 1 [] | 2 [] | 3 [] | 4 [] | 5 [] |
| e) Savings | 1 [] | 2 [] | 3 [] | 4 [] | 5 [] |
| f) Micro insurance | 1 [] | 2 [] | 3 [] | 4 [] | 5 [] |

- g) Commercial banks 1 |]2[| 3[| 4[| 5[]
 h) Savings and credit societies SACCOS 1 |]2[| 3[| 4[| 5[]

3. Bargaining power for the financial Suppliers

12. Do you think the financial suppliers in the MFIs industry have a bargaining power?

- Yes No Not sure

13. To what extent does bargaining power of financial suppliers affect competition in the industry?

- 05 Greatly Affects 04 Affects 03 slightly affects 02 Does not affect
 01 Not sure

14. To what extent do you consider the following factors to a be a source of bargaining power for the financial Suppliers in the microfinance industry? In terms of (1-5) (5 is the highest, 1 lowest) Tick appropriately

- a) Importance of donors in local industry 1 |]2[| 3[| 4[| 5[]
 b) Ease of getting access to capital from donors 1 |]2[| 3[| 4[| 5[]
 c) Ease of getting capital from commercial sources 1 |]2[| 3[| 4[| 5[]
 d) Current health of financial system and liquidity conditions
 1 |]2[| 3[| 4[| 5[]
 e) Kenya's MFIs credit rating 1 |]2[| 3[| 4[| 5[]
 f) Existence of loan guarantees and other mechanisms to facilitate linkages with formal financial sector 1 |]2[| 3[| 4[| 5[]

4. Bargaining power of customers

15. What would you consider to be the main source of bargain Power for microfinance customers?

- a) Existence of viable alternate providers 1 |]2[| 3[| 4[| 5[]
 b) Number of potential customers relative to providers 1 |]2[| 3[| 4[| 5[]
 c) Level of knowledge of customers 1 |]2[| 3[| 4[| 5[]
 d) Level of awareness of other providers 1 |]2[| 3[| 4[| 5[]
 e) Price sensitivity of customers 1 |]2[| 3[| 4[| 5[]
 f) Difficulty of switching from one MFI to another 1 |]2[| 3[| 4[| 5[]
 g) Customer loyalty to the institution 1 |]2[| 3[| 4[| 5[]

5. Rivalry among Existing Competitors

16 Rivalry among Existing Competitors

- a) Degree of market penetration by other providers 1 | 2| 3| 4| 5|
- b) Stage of industry growth 1 | 2| 3| 4| 5|
- c) Number of other MF providers 1 | 2| 3| 4| 5|
- d) Level of skill and development of other providers 1 | 2| 3| 4| 5|
- e) Presence of non-traditional providers, such as banks, cooperatives 1 | 2| 3| 4| 5|

5. What strategies has your institution put in place in order to survive the survive in the competitive environment?

5.1 Strategies already implemented

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5.2 Strategies to be implemented

.....

6. Below are some of the factors that are likely to impact on the success of MFIs in Kenya. In order of importance, what ranks would you assign to each factor on a scale of (1-5), (5 highest, 1 lowest)

6.1 Board and Management: (Genuine commitment from the board and management; Free hand in decision-making.)

1	2	3	4	5
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6.2 Environment: (Policy environment; Regulatory environment.)

1	2	3	4	5
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6.3 Institutional Factors: (Bank structure; Access to underserved market; Costs; Training; Personnel.)

1	2	3	4	5
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6.4 Products: (Careful product design; Agile loan process; Portfolio quality; Marketing.)

1	2	3	4	5
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6.5 Industry Competition: (Competition from other institutions: MFIs, Banking institutions, SACCOs)

1	2	3	4	5
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Thank you very much for your valuable support in this research